HSBC Bank Canada
Annual Report and Accounts 2009

HSBC
The world's local bank

www.hsbc.ca

Corporate Profile

HSBC Bank Canada, a subsidiary of HSBC Holdings plc, has more than 260 offices, including over 140 bank branches, and is the leading international bank in Canada. With around 8,000 offices in 87 countries and territories and assets of US$2,364 billion at December 31, 2009, the HSBC Group is one of the world's largest banking and financial services organizations.

Contents

Dividend record and payable dates in 2010 for our preferred shares, subject to approval by our Board of Directors, are:

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

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

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

Shareholder Information

PRINCIPAL ADDRESSES:

Vancouver:
HSBC Bank Canada
885 West Georgia Street
Vancouver, British Columbia
Canada V6C 3E9
Tel: (604) 685-1000
Fax: (604) 641-2506

Toronto:
HSBC Bank Canada
70 York Street
Toronto, Ontario
Canada M5J 1S9
Tel: (416) 868-8000
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Media Enquiries:
Ernest Yee (604) 641-2973
Sharon Wilks (416) 868-3878

WEBSITE:

hsbc.ca

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

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

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

TRANSFER AGENT AND REGISTRAR:

Computershare Investor Services Inc.
Shareholder Service Department
9th Floor, 100 University Avenue
Toronto, Ontario
Canada M5J 2Y1
Tel: 1 (800) 564-6253
Fax: 1 (866) 249-7775

SHAREHOLDER CONTACT:

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

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

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

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

Caution Concerning Forward-Looking Statements

This document contains forward-looking information, including statements regarding the business and anticipated actions of the bank. These statements can be identified by the fact that they do not pertain strictly to historical or current facts. Forward-looking statements often include words such as "anticipates," "estimates," "expects," "projects," "intends," "plans," "believes" and words and terms of similar substance in connection with discussions of future operating or financial performance. Examples of forward-looking statements include, but are not limited, to statements made in "Message from the President and Chief Executive Officer" on page 3, "Economic Outlook for 2010" and "Our Focus for 2010" on page 9, "Employee future benefits" on page 15, and "Transition to IFRS" on page 18. These statements are subject to a number of risks and uncertainties that may cause actual results to differ materially from those contemplated by the forward-looking statements. Some of the factors that could cause such differences include legislative or regulatory developments, technological change, global capital market activity, changes in government monetary and economic policies, changes in prevailing interest rates, inflation levels and general economic conditions in geographic areas where the bank operates. Canada is an extremely competitive banking environment, and pressures on our net interest margin may arise from actions taken by individual banks or other financial institutions acting alone. Varying economic conditions may also affect equity and foreign exchange markets, which could also have an impact on our revenues. The factors disclosed above are not exhaustive, and there could be other uncertainties and potential risk factors not considered here which may affect our results and financial condition. Any forward-looking statements speak only as of the date of this document. We undertake no obligation to, and expressly disclaim any obligation to, update or alter our forward-looking statements, whether as a result of new information, subsequent events or otherwise, except as required by law.

Message from the President and Chief Executive Officer

In a year marked by significant market volatility and economic pressures, I am pleased with the way HSBC Bank Canada has been able to manage through these challenges. We draw great strength from being a member of the HSBC Group, one of the most strongly capitalized and liquid banks in the world, which has enabled us to continue to support our customers' credit, deposit and investment needs through the difficult economic environment. We anticipate increased demand for our delivery of global financial services to Canadians in 2010 as conditions improve.

Awareness of the HSBC brand in Canada is now at record high levels and improving year on year. This year HSBC also had the second highest recommendation scores in comparison with our competitors for both personal and commercial financial services according to Synovate Limited and TNS Finance. I would like to thank our customers for their continued commitment to the bank and the vote of confidence these rankings represent.

Despite the difficult economic environment we have been able to build on past successes and position the bank for the future. We continued our strategy of bringing the world to Canadians through the introduction of a number of new global products and services including the Indian Equity Fund, which gives HSBC the largest suite of emerging markets funds in Canada; the addition of three new international markets for trading online at HSBC InvestDirect; and the Canadian launch of HSBC's World Selection investment service. Finally, we were pleased to launch a suite of services for small business including BusinessVantage, the BusinessVantage MasterCard, the on-line HSBC Knowledge Centre and BusinessDirect, a new free online banking package.

In addition to offering new products and services, we also successfully completed a realignment of our Personal Financial Services and Commercial Banking staff to better serve our customers and offer clear career paths to our employees through specialization.

We were pleased to reaffirm our commitment to Canada and the lower mainland of BC by moving in to Discovery Green, a new state-of-the art, environmentally sustainable, global software development centre in Burnaby. Discovery Green was recently awarded LEED Platinum-CS from the US Green Building Council, one of just two buildings in Canada to receive this designation. We also announced plans for a new corporate centre in Vancouver which will bring together staff from five locations around Vancouver into one building. The HSBC Centre, which we expect to occupy in 2012, is being built to achieve a standard of LEED Gold or higher.

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

Lindsay Gordon
President and Chief Executive Officer
HSBC Bank Canada

Vancouver, Canada
February 16, 2010

Management's Discussion and Analysis

Five Year Financial Summary

(in $ millions, except where stated)	Years Ended December 31				
	2009	2008	2007(1)	2006(1)	2005(1)
Condensed statements of income					
Net interest income	$ **1,479**	$ 1,644	$ 1,718	$ 1,545	$ 1,391
Non-interest revenue	**951**	837	781	690	598
Total revenue	**2,430**	2,481	2,499	2,235	1,989
Non-interest expenses					
Salaries and employee benefits	**642**	644	687	624	543
Premises and equipment(2)	**165**	153	142	133	122
Other	**370**	433	442	372	344
Total non-interest expenses	**1,177**	1,230	1,271	1,129	1,009
Net operating income before provision for credit losses	**1,253**	1,251	1,228	1,106	980
Provision for credit losses	**515**	379	239	175	157
Income before taxes	**738**	872	989	931	823
Provision for income taxes	**207**	253	347	324	270
Non-controlling interest in income of trust	**26**	26	26	26	22
Net income	$ **505**	$ 593	$ 616	$ 581	$ 531
Preferred share dividends	**57**	20	18	18	13
Net income attributable to common shares	$ **448**	$ 573	$ 598	$ 563	$ 518
Basic earnings per common share ($)	**0.90**	1.09	1.16	1.09	1.00
Financial ratios (%)(3)					
Return on average common equity	**13.1**	16.6	19.6	20.8	21.1
Return on average total assets	**0.62**	0.77	0.88	0.96	1.02
Net interest margin	**2.40**	2.59	2.91	2.97	3.03
Non-interest revenue: total revenue ratio	**39.1**	33.7	31.3	30.9	30.1
Cost efficiency ratio	**48.4**	49.6	50.9	50.5	50.7
Credit information					
Gross impaired credit exposures	**1,022**	932	420	302	269
Allowance for credit losses					
Balance at end of period	**638**	615	514	473	459
As a percentage of gross impaired credit exposures (%)	**62**	66	122	157	171
As a percentage of gross loans and acceptances outstanding (%)	**1.46**	1.24	1.03	1.05	1.15
Average balances(3)					
Assets	$ **71,695**	$ 73,952	$ 68,194	$ 58,464	$ 50,777
Loans	**39,644**	44,331	42,351	37,818	34,053
Deposits	**51,436**	52,109	47,484	41,906	37,342
Common equity	**3,417**	3,462	3,051	2,705	2,457
Balance sheet highlights					
Total assets	**71,337**	72,049	68,130	61,448	53,082
Total loans and acceptances, net of allowance for credit losses	**43,070**	48,855	49,322	44,707	39,469
Business and government loans	**18,442**	23,067	21,322	17,819	15,571
Residential mortgage loans	**11,359**	11,869	12,920	14,016	12,865
Total deposits	**50,207**	51,962	48,878	44,174	38,610
Deposits from individuals	**21,578**	21,064	18,292	17,040	15,302
Shareholders' equity	**4,364**	4,153	3,612	3,210	2,898
Risk-based capital ratios (%)(4)					
Tier 1 capital	**12.1**	10.1	8.8	9.0	9.0
Total capital	**14.9**	12.5	11.3	11.1	11.2
Funds under management	$ **28,174**	$ 21,287	$ 26,213	$ 23,340	$ 20,453
Custodial accounts	**10,721**	9,221	10,914	8,574	7,594
Total assets under administration	$ **38,895**	$ 30,508	$ 37,127	$ 31,914	$ 28,047

(1) *Reported comparative periods were restated in 2008 for the impact of the acquisition of HSBC Financial Corporation Limited in 2008. Refer to note 2 on pages 59 to 61.*
(2) *Includes amortization of premises and equipment.*
(3) *These are non-GAAP amounts or non-GAAP measures. Please refer to the discussion outlining the use of non-GAAP measures in this document on page 5.*
(4) *Calculated in accordance with guidelines issued by the Office of the Superintendent of Financial Institutions Canada ("OSFI"). Effective January 1, 2008, the bank adopted a revised capital adequacy framework, refer to page 24 for further information. Reported comparative periods' capital ratios were not restated for the impact of the acquisition of HSBC Financial Corporation Limited as it is not meaningful to restate these ratios.*

HSBC Bank Canada's ("the bank", "we", "our") Management's Discussion and Analysis ("MD&A") is dated February 16, 2010, the date that our consolidated financial statements and MD&A for the year ended December 31, 2009 were approved by our Board of Directors ("the Board").

Basis of preparation of financial information. We prepare our consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). The financial information included in the MD&A is either at December 31, or for the years then ended. The information is derived either directly from our consolidated financial statements or from the information we have used to prepare them. Unless otherwise stated, all references to "$" means Canadian dollars. All tabular amounts are in millions of dollars except where otherwise stated. Certain financial information that we are required to disclose as part of the MD&A is included in the table on page 4, which also includes a number of GAAP and non-GAAP measures. Securities regulators require that companies caution readers that earnings and other measures adjusted to a basis other than GAAP may not have any standardized meaning prescribed by GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. The following outlines various GAAP or non-GAAP measures which management regularly monitors, to more clearly indicate the derivation of the measure:

– *Return on average common equity* – Calculated as net income attributable to common shares divided by average common equity.

– *Return on average assets* – Calculated as net income attributable to common shares divided by average assets.

– *Net interest margin* – Calculated as net interest income divided by average interest-earning assets.

– *Cost efficiency ratio* – Calculated as non-interest expenses divided by total revenue.

– *Non-interest revenue: total revenue ratio* – Calculated as non-interest revenue divided by total revenue.

– *Average balances* – Average assets, average interest-earning assets, loans, and deposits are calculated using daily average balances for the year. Average common equity is calculated using month end balances of common equity for the year.

The sections on risk management included in this MD&A where indicated on pages 25 to 39 form an integral part of the consolidated financial statements and should be read in conjunction with the consolidated financial statements for the year ended December 31, 2009 and the related auditors' report.

We make a number of references throughout this MD&A to "notes" which means notes to the 2009 audited consolidated financial statements, which are included with the MD&A in our Annual Report and Accounts.

Other available information. We file all of our news releases regarding material matters, interim and annual consolidated financial statements, interim and annual MD&A, Annual Reports, Annual Information Form, certifications by our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), as well as other continuous disclosure documents, with SEDAR. Copies of these documents can be obtained from SEDAR's website: sedar.com and our website: hsbc.ca. Certain financial information for one of the bank's subsidiaries, HSBC Financial Corporation Limited ("HSBC Financial") can also be located on sedar.com.

Outstanding securities data. Note 13 on page 70 contains details of the number of preferred and common shares issued and outstanding at December 31, 2009. Note 11 on page 68 contains details of the number of HSBC Canada Asset Trust Securities ("HSBC HaTS™") outstanding at December 31, 2009. Subsequent to that date and up to the date of this MD&A, there have been no issues of any form of securities.

Management's Discussion and Analysis (continued)

Overview

In Canada, we are the largest full-service, internationally owned bank and seventh largest bank overall with operations across the country and total assets of more than $71 billion at December 31, 2009.

Originally established in 1981, with our head office located in Vancouver, British Columbia, we have grown organically and through strategic acquisitions, to become an integrated financial services organization. With more than 260 offices across Canada, including 145 bank branches, we provide personal and commercial banking services, global banking and market services, retail brokerage, wealth management, personal trust services and consumer finance services.

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

In 2008, we acquired HSBC Financial Corporation Limited ("HSBC Financial") from a US affiliate. HSBC Financial was originally established in 1928 and provides a wide range of consumer finance products and services to Canadian customers through its network of 76 branches. Results for 2008 and prior years were restated in 2008 to combine the previously reported results of the bank with those of HSBC Financial to reflect the continuity of interests method of accounting. References in this MD&A to "banking operations" relate to those excluding the Consumer Finance business of HSBC Financial.

The HSBC Group

We are a member of the HSBC Group, whose parent company HSBC Holdings plc ("HSBC Holdings") is headquartered in London, UK. Our customers have access to the worldwide resources of the HSBC Group. Known as "The world's local bank", the HSBC Group is one of the largest banking and financial services organizations in the world, with an international network in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa. Shares in HSBC Holdings are listed on the London, Hong Kong, New York, Paris and Bermuda stock exchanges. The shares are traded in New York in the form of American Depositary Receipts.

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

Complete financial and operational information for HSBC Holdings and the HSBC Group can be obtained from its website, hsbc.com, including copies of HSBC Holdings 2009 Annual Review and its 2009 Annual Report and Accounts.

Our Business Focus

Strategy

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

Our Customers

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

Our Brand

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

Our Culture

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

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

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

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

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

Customer Groups

We manage and report our operations around the following customer groups: Personal Financial Services, Commercial Banking, Global Banking and Markets and Consumer Finance. We have built a culture that delivers integrated service ensuring customer needs are met across products, subsidiaries, and internationally through the HSBC Group's worldwide network.

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

Commercial Banking provides financial services and products to small, medium-sized and middle market businesses, including sole proprietors, partnerships, clubs and associations, incorporated businesses and publicly quoted companies. In addition to direct lending, our range of products and services includes payments and cash management, treasury and capital markets, investment and merchant banking, wealth management services, trade services and leasing. Of particular relevance to Canadian businesses is HSBC's extensive network in the NAFTA countries, South America, Europe and Asia. We provide this service through commercial branches and subsidiary offices, including those of HSBC Securities (Canada) Inc., HSBC Global Asset Management (Canada) Limited and HSBC Capital (Canada) Inc., as well as through the HSBC Group's worldwide network.

Global Banking and Markets serves Canadian and international corporations, institutions and governments that require both domestic and international financial services. Global Banking and Markets provides a comprehensive range of financial services including treasury and capital markets services, raising public and private capital, corporate finance and advisory services, direct lending, leasing finance and deposit-taking. We also offer payments and cash management and trade services. We provide Global Banking and Markets services through our principal branches and subsidiary offices, coordinated with HSBC Group worldwide operations through one relationship manager. Our ability to leverage the HSBC Group's worldwide network in providing comprehensive global banking and market services to sophisticated multinational clients is a significant competitive advantage.

Consumer Finance, through the bank's wholly-owned subsidiary, HSBC Financial, acquired in 2008, provides consumer finance products and solutions to Canadians through a network of 76 retail branches and other distribution channels. Products include real estate secured loans, personal loans, specialty insurance products and credit cards, including private-label credit cards to retail merchants.

Management's Discussion and Analysis (continued)

Highlights For 2009

2009 was another year of progress for us as we continued to execute our strategy to build our business in Canada. Particularly noteworthy accomplishments included:

Our Customers – We completed the re-alignment of our branch network to provide greater depth of expertise and specialization within Personal Financial Services and Commercial Banking, improving client service and enhancing work experiences for our staff.

Our customer service excellence in both Personal Financial Services and Commercial Banking was recognized in our Customer Recommendation Index. In the Commercial market, we are ranked among the top Canadian banks in the competitive set identified by HSBC (independent research carried out by TNS Finance[1]).

Our Brand – HSBC combines global reach with local knowledge to meet the needs of customers around the world. We offer a full range of financial services in a different way from our competitors. This means helping clients reach their goals faster through fresh ideas and innovative solutions.

As part of this effort in Canada, the HSBC brand is on the interiors and exteriors of the fixed links and jet bridges that carry passengers to aircrafts at the Vancouver International Airport and Toronto's Pearson International Airport and is part of a unique international branding strategy undertaken by HSBC Group to demonstrate our global presence at a local level, covering global centers such as London (Heathrow), New York (Kennedy and LaGuardia), Los Angeles (LAX) and Tokyo (Narita).

Our branding efforts were recognized in the strength of HSBC's Commercial Banking Brand Health Index (independently researched by TNS Finance[1]), putting us within the top three of our competitors.

Our Culture – In 2009, HSBC Group conducted its third Global People Survey. The results for Canadian employees included a very high participation rate (86 per cent) and bank employee engagement scores increased from 75 per cent in 2008 to 76 per cent in 2009, meeting our target.

We have received recognition from MediaCorp as one of "BC's Top 50 Employers" one of twenty-five "Canada's Best Diversity Employers" and "Best Employers for 50-Plus Canadians" as featured in various publications across the country. We were commended for creating an internal scorecard for diversity initiatives, performance objectives, training and an awards program.

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

Our Businesses – Executing against the HSBC strategy of being "The Best Bank for Small Business" we launched HSBC Business Direct to better serve and attract Business Banking clients. We continued to leverage on HSBC Business Vantage, a portfolio of services designed to meet the needs of small to medium-sized business banking clients.

In Personal Financial Services, we launched a number of new, innovative products including the HSBC Smart Savers Mortgage and HSBC Indian Equity Fund, giving HSBC one of the broadest line ups of emerging markets funds in the country.

Our Technology and Process – The HSBC Group has embarked on a global "One HSBC" project to streamline its business processes and products around the needs of its customers, and provide world class, globally consistent technology to support the HSBC business across all geographies and all customer groups. The Canadian bank has commenced design and planning for expected implementation of "One HSBC" in Canada in 2010.

Our Organization – Amidst a challenging year in 2009, the execution of our strategy, including our prudent lending standards has helped us maintain our strong capital base, strong liquidity and diversified income stream. We plan to continue our existing strategy of working with customers to meet their personal and business needs while maintaining close control over credit quality.

[1] *TNS Finance conducted telephone interviews from August to November 2009 among businesses with turnover up to $35 million.*

Economic Outlook For 2010

We expect the economy to improve slowly through 2010, evidenced by positive signs in unemployment, home sales and consumer confidence. Interest rates are expected to stay low for the first half of 2010 with minor increases expected in the third and fourth quarters as the economy improves.

We anticipate 2010 to be a continuation of the extremely competitive environment for both personal and commercial business in Canada, with continued pressure on margins and funding. However, with our focus on key principles of a strong capital base, a diversified income stream and strong liquidity, we intend to position the bank to maximize opportunities and to stay focused on our "right to win" strategy in target segments.

Our Focus For 2010

During 2010, we plan to grow our business by focusing on the following:

Our Customers – We will focus on our customers and segments where we have a "right to win". In Personal Financial Services, we will leverage our international capabilities to enhance our premium and wealth management proposition, delivering global connectivity in key cultural segments. In Commercial Banking, we will continue our leading international banking business strategy, focusing on businesses with international needs.

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

Our Culture – In order to build on our customer service excellence, we will enhance recruitment initiatives and engage employees while tying management performance more closely to our annual employee engagement survey, creating the best place to work measured by best in class engagement scores.

Our Global Distribution – We will continue to focus on opportunities and product support (information technology, marketing and product) throughout the HSBC Group to leverage and drive growth across all business lines. Specifically, we aim to improve efficiency through the "One HSBC" business platforms and leverage Centres of Excellence and Global Resourcing Centres. We will continue to drive new leads via Global Links, our international Commercial Banking customer referral system, and align key performance metrics to drive referral business internally.

Our Business – We will expand our small to medium enterprise customer segment, aiming to be the "The Best Bank for Small Business", investing in our Business Direct and Business Banking capabilities. We aim to enhance our payments and cash management capabilities, improve wealth management capabilities, integrate and better cross-sell between HSBC entities.

Our Technology and Process – We plan to ensure successful phased implementation of "One HSBC" in 2010, "joining up" with HSBC on a global level. The objective of "One HSBC" is to build a single, modern, global business platform to meet the needs of our customers, shareholders and staff. "One HSBC" will allow us to deliver a consistent customer experience worldwide, while leveraging our global scale. It will also contribute to reduction of waste through the elimination of inefficient processes and unnecessary costs, while supporting our environmental sustainability targets through a paperless system.

Our Organization – HSBC remains one of the largest, most strongly capitalized and liquid banks in the world. We will continue to maximize capital efficiency, exceeding all regulatory capital requirements. We will continue to operate within HSBC Group limits and guidelines, deepen management experience through HSBC Group's resources, ensure investments made meet HSBC Group's key performance metrics and leverage off HSBC Group first as we join up. We will continue to manage and mitigate our credit and operational risk by staying close to our customers.

Analysis of Financial Results For 2009

- Net income attributable to common shares was $448 million for the year ended December 31, 2009, a decrease of 21.8 per cent compared with $573 million for 2008.
- Return on average common equity was 13.1 per cent for the year ended December 31, 2009 compared with 16.6 per cent for 2008.

Management's Discussion and Analysis (continued)

– The cost efficiency ratio was 48.4 per cent for the year ended December 31, 2009 compared with 49.6 per cent for 2008.

– Total assets were $71.3 billion at December 31, 2009, a decrease of $0.7 billion, or 1.0 per cent, from $72.0 billion at December 31, 2008.

– Total funds under management were $28.2 billion at December 31, 2009, an increase of $6.9 billion, or 32.4 per cent, from $21.3 billion at December 31, 2008.

Overview

Net income attributable to common shares for the year ended December 31, 2009 was $448 million, a decrease of $125 million or 21.8 per cent compared with $573 million for 2008. Net income attributable to common shares for 2009 from core banking operations, which consists of` Personal Financial Services, Commercial Banking and Global Banking and Markets, was $494 million, $30 million or 5.7 per cent lower than 2008 and from Consumer Finance was a loss of $46 million, $95 million or 194 per cent lower than 2008.

While net income was down over the year, these results show resilience given the significant market challenges. Pre-tax results from our core banking operations were less than 3.0 per cent lower than 2008, despite the impact of increased credit losses.

Net interest income

For the year ended December 31, 2009, net interest income was $1,479 million compared with $1,644 million for 2008, a decrease of $165 million, or 10 per cent. This resulted from lower average interest earning assets of $61.6 billion compared to $63.6 billion, together with the impact of a reduction of net interest margin to 2.40 per cent from 2.59 per cent. Central bank actions to correct adverse economic conditions saw multiple reductions in the prime rate during 2008 and 2009. This resulted in reduced interest income on floating rate loans that was not offset by an equal reduction in interest expense as our deposits re-priced downwards more slowly over the period. Also impacting net interest margin was the reduction in the value of interest free funds and low interest deposits in a falling interest rate environment as well as the lower rates earned on government and other securities, which represented a higher proportion of earning assets compared to previous periods. Wider credit spreads experienced across the banking industry also adversely impacted the relative cost of wholesale funding compared with 2008. The reduction in average interest earning assets also reflected the sale of the automobile loan portfolio in July 2008, as well as reduced customer borrowings, particularly in our commercial banking business, although this was partially offset by increased holdings of lower yielding government securities.

Non-interest revenue

For 2009, non-interest revenue was $951 million, $114 million, or 13.6 per cent, higher compared with $837 million for 2008. Capital market fees increased by $65 million reflecting very strong capital market activities during 2009 resulting in increases in commissions, proprietary trading revenues and debt and equity underwriting and advisory fees. Credit fees increased by $41 million resulting from commercial banking pricing initiatives. Securitization income was $15 million higher due to increased volumes and lower funding rates. Gains on available-for-sale ("AFS") and other securities were $74 million better mainly due to other-than-temporary impairment ("OTTI") of $62 million recognized in 2008 relating to non-bank Canadian Asset-Backed Commercial Paper ("ABCP") and other AFS securities compared to $20 million recorded on certain mortgage-backed securities in 2009. Investment administration fees were $13 million lower due to lower average market values of customer portfolios and foreign exchange revenues were $8 million lower due to lower trading volumes in 2009 arising from less volatile markets. Other non-interest revenue was $13 million lower mainly as a result of a reduction in the number of closed Canadian Investor Immigrant Program transactions. Trading revenue was $67 million lower due to less volatility in foreign exchange and interest rates resulting in less favourable trading conditions together with an increase in the mark-to-market writedown of non-bank ABCP of $16 million. Other net mark-to-market accounting gains and losses, including changes in the value of our own debt obligations designated at fair value, US$ denominated funding of US$ denominated AFS securities where the corresponding translation gains or losses are recorded in shareholders' equity through accumulated other comprehensive income and derivatives used for hedging purposes, were $22 million higher than the previous year. The increase reflects the impact of the considerable strength of the Canadian dollar compared to the US dollar on US$ denominated funding of AFS securities and the effect of changing interest rates on hedging derivatives, partially offset by the impact of tightening credit spreads on the fair value of our own debt.

Non-interest expenses and operating efficiency

For 2009, non-interest expenses were $1,177 million compared with $1,230 million for 2008, a decrease of $53 million, or 4.3 per cent. Salaries and employee benefits were little changed, reflecting a lower number of staff, particularly in the Consumer Finance business as a result of reductions in its branch network offset by higher variable compensation due to increased capital markets related activities as well as the impact in 2008 of a release of a valuation allowance previously applicable to pension plan assets. Premises and equipment costs increased by $12 million, in part from increased computer costs as well as increased amortization costs arising from higher investments in new premises in key target markets. Other non-interest expenses were $63 million lower due to reductions in information technology expenses, lower commodity tax provisions, certain transaction related costs and the impact of cost control initiatives including corporate travel and other discretionary expenses. Despite the reduction in net interest income, the lower cost base resulted in an improved cost efficiency ratio for the year ended December 31, 2009 of 48.4 per cent compared to 49.6 per cent in 2008.

Credit quality and provision for credit losses

The provision for credit losses for 2009 was $515 million compared to $379 million for 2008. The increased charge in 2009 compared to 2008 was due to an increase in specific provisions for credit losses arising from the challenging credit environment that existed throughout 2009. The provision for credit losses from banking operations for 2009 was an increase of $126 million over 2008, mainly in the commercial mid-market and real estate sectors. Credit loss provisions for Consumer Finance operations for 2009 increased by $10 million to $238 million compared with $228 million in 2008.

Gross impaired credit exposures were $1,022 million, or $90 million higher compared with $932 million at December 31, 2008. Total impaired exposures, net of specific allowances for credit losses, were $836 million at December 31, 2009 and $770 million at December 31, 2008. However, the total of impaired exposures includes $214 million (2008 – $207 million) of Consumer Finance and other consumer loans, for which impairment is assessed collectively and no specific impairment is recorded. The increase in impaired credit exposures was driven by the deterioration of economic conditions across all business sectors that took place during 2009.

The general allowance for credit losses applicable to business and government loans in the banking portfolio was reduced by $14 million to $220 million compared to December 31, 2008. This arose as a result of a reduction of the performing commercial loan portfolio during 2009 of $4.9 billion. The general allowance applicable to Consumer Finance loans was $201 million compared to $194 million at December 31, 2008. The total allowance for credit losses, as a percentage of loans and acceptances outstanding, was 1.46 per cent at December 31, 2009 compared with 1.24 per cent at December 31, 2008. The bank considers the total allowance for credit losses to be appropriate given the credit quality of its portfolios and the current credit environment.

Income taxes

The effective tax rate for 2009 was 29.1 per cent compared with 29.9 per cent in 2008. The lower tax rate in 2009 arises from a reduction in statutory tax rates, together with the impact of a higher release of a pension plan allowance in 2008, which is not taxable, as well as the impact of lower tax rates on future income.

Balance sheet

Total assets at December 31, 2009 were $71.3 billion, a decrease of $0.7 billion from December 31, 2008. The decrease from December 31, 2008 mainly resulted from lower demand for commercial credit due to a de-leveraging by clients of their balance sheets and lower consumer finance receivables. This was partially offset by an increase in liquid assets and securities. Commercial loans and acceptances decreased from the end of 2008 by $4.9 billion to $23.4 billion. Although net residential mortgages decreased during 2009, activity in housing markets resulted in higher mortgage originations with the result that overall, mortgage loans increased by 3.2 per cent compared with December 31, 2008. After securitizations there was an overall decrease of $0.5 billion or 4.2 per cent. Consumer loans and personal lines of credit in the Personal Financial Services business were up by $0.4 billion to $5.7 billion while receivables of the Consumer Finance business decreased by $0.8 billion as a result of lower loan originations arising from credit tightening decisions. Liquidity remained strong at December 31, 2009, with more than $25.1 billion of cash resources, securities and reverse repurchase agreements compared to $19.4 billion at December 31, 2008.

Management's Discussion and Analysis (continued)

Total deposits decreased by $1.8 billion to $50.2 billion at December 31, 2009 from $52.0 billion at December 31, 2008. Personal deposits grew by $0.5 billion over December 31, 2008 mainly driven by growth in the number of High Rate and Direct Savings accounts, and core commercial deposits grew by $0.7 billion, resulting from increased activity in our payments and cash management business. However, higher cost wholesale deposits, included in business and government deposits, decreased by $3.8 billion as a result of funding from securitizations of $3.5 billion and lower client borrowings.

Total assets under administration

An increase in equity markets as well as new product sales resulted in an increase in funds under management to $28.2 billion at December 31, 2009 from $21.3 billion at December 31, 2008. Including custody and administration balances, total assets under administration were $38.9 billion, compared with $30.5 billion at December 31, 2008.

Quarterly Summary of Condensed Statements of Income

	2009				2008			
	Quarter ended				Quarter ended			
	Dec. 31	*Sept. 30*	*June 30*	*March 31*	*Dec. 31*	*Sept. 30*	*June 30*	*March 31*
				(Unaudited)				
Net interest income	**$ 393**	**$ 368**	**$ 368**	**$ 350**	$ 375	$ 421	$ 423	$ 425
Non-interest revenue	**267**	**190**	**251**	**243**	223	171	204	239
Total revenue	**660**	**558**	**619**	**593**	598	592	627	664
Non-interest expenses	**292**	**291**	**303**	**291**	295	314	311	310
Net operating income before provision for credit losses	**368**	**267**	**316**	**302**	303	278	316	354
Provision for credit losses	**131**	**97**	**126**	**161**	136	86	82	75
Income before taxes	**237**	**170**	**190**	**141**	167	192	234	279
Provision for income taxes	**66**	**48**	**54**	**39**	38	62	64	89
Non-controlling interest in income of trust	**7**	**6**	**7**	**6**	7	6	7	6
Net income	**$ 164**	**$ 116**	**$ 129**	**$ 96**	$ 122	$ 124	$ 163	$ 184
Preferred share dividends	**16**	**15**	**15**	**11**	7	4	5	4
Net income attributable to common shares	**$ 148**	**$ 101**	**$ 114**	**$ 85**	$ 115	$ 120	$ 158	$ 180
Basic earnings per share ($)	**0.30**	**0.20**	**0.23**	**0.17**	0.22	0.23	0.30	0.34

The unaudited quarterly information contains all adjustments necessary for a fair presentation of such information. All such adjustments are of a normal and recurring nature. Most of our revenues are non-seasonal in nature, although there can be an increase in non-interest revenues in the first quarter of the year associated with personal investments arising from retirement planning activity in Canada. Other seasonal factors have a minor impact on our results in most quarters. The first quarter has the fewest number of days, and therefore net interest income may be lower compared with the other three quarters.

The credit and liquidity crisis has affected market rates, resulting in increased credit spreads, falling interest margins and lower value from interest free deposits. Economic actions taken by central banks in lowering prime rates resulted in a falling interest rate environment. Due to the composition of the bank's portfolio, average loans re-priced downwards more quickly than deposits. This led to a consequent reduction of net interest income since the end of 2007 to the first quarter of 2009. As a result of the benefit of pricing initiatives on commercial loan spreads which commenced at the end of 2008, the stabilizing of market interest rates and the beneficial impact from lower credit spreads on the cost of wholesale funds, net interest income stabilized in the second and third quarters of 2009 and improved in the fourth quarter of 2009.

External market forces caused a considerable degree of volatility in interest and foreign exchange rates as well as changing credit spreads, which resulted in significant variability in reported non-interest revenues over the past eight quarters, particularly those relating to trading activities and marking to market of derivatives. After recording significant falls in 2008, Canadian equity markets experienced a considerable recovery in 2009, which led to increases in capital market related revenues. In addition, commercial pricing initiatives noted above also had an upward impact on credit fees earned from off-balance sheet commercial credit facilities such as Bankers' Acceptances, guarantees and letters of credit.

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

Costs have shown an improvement as a result of restructuring by HSBC Financial and cost control initiatives in the bank.

Over the last eight quarters, our business has been affected by a number of favourable and unfavourable items. In the third quarter of 2008, a loss of $41 million, including related expenses, was recorded as a reduction of other income on the sale of the automobile loan portfolio. During the third and fourth quarters of 2008, we recorded additional charges and write-downs related to our holdings of non-bank ABCP of $15 million and $58 million, respectively. The non-bank ABCP was restructured in the first quarter of 2009. We recorded additional charges and write-downs on our holdings of the restructured non-bank ABCP in 2009 of $22 million in the first quarter, income of $15 million in the second quarter, and charges and write-downs of $54 million and $3 million in the third and fourth quarters respectively. In the first quarter of 2009, we recorded a provision of $20 million in respect of a loss contingency arising from a transaction occurring in a previous year. In the second quarter of 2009, gains on AFS securities of $27 million were realized upon the sale of certain securities. OTTI losses on AFS securities of $1 million, $6 million, $12 million and $1 million were recorded in the first, second, third and fourth quarters of 2009, respectively, compared to an OTTI loss of $8 million in the fourth quarter of 2008.

Analysis of financial results for the fourth quarter, 2009

Net interest income

Net interest income in the fourth quarter of 2009 was $393 million, compared with $375 million for the same quarter in 2008, an increase of $18 million, or 4.8 per cent. This resulted from an increase in net interest margin to 2.52 per cent in the quarter compared with 2.33 per cent in the same quarter of 2008, offset by a decrease in average interest earning assets from $64.1 billion to $61.9 billion.

Net interest income from core banking operations increased by $37 million or 13.9 per cent. This was as a result of an increase in net interest margin to 2.06 per cent in the fourth quarter from 1.78 per cent in the same period last year, while average interest earning assets decreased from $59.8 billion to $58.5 billion. The net interest margin for core banking operations increased as a result of pricing initiatives on commercial loans, repricing of fixed deposits and the beneficial impact on the cost of wholesale funds from lower credit spreads. The interest margin in the fourth quarter of 2008 reflected reductions in prime rates following actions taken at that time by central banks arising from adverse economic conditions while rates on deposits re-priced downward less quickly, as well as the impact of widening credit spreads on the cost of wholesale funds.

Net interest income for the Consumer Finance business decreased by $19 million or 17.6 per cent compared to the same quarter in 2008 mainly as a result of a reduction in average receivables, including consumer finance, automobile and other loans of 19.5 per cent to $3.3 billion.

Net interest income in the fourth quarter of 2009 increased by $25 million or 6.8 per cent compared to the third quarter of 2009, while net interest margin increased to 2.52 per cent from 2.36 per cent. The net interest margin for banking operations increased by 14 basis points compared to the third quarter as a result of pricing initiatives on commercial loans reflecting changes in the credit environment, and the impact of fixed deposits re-pricing at lower rates. The cost of funds reduced as a result of lower rates paid on wholesale deposits resulting from tighter credit spreads. In addition, the Consumer Finance business was adversely impacted in the third quarter by a provision relating to merchant discounts.

Management's Discussion and Analysis (continued)

Non-interest revenue

Non-interest revenue was $267 million in the fourth quarter of 2009, compared with $223 million for the same quarter in 2008, an increase of $44 million, or 19.7 per cent. Capital market fees were $36 million higher due to increased activities in underwriting, advisory, equity and debt markets in 2009, which resulted in higher commissions earned on client trading activities. Securitization income was $17 million higher due to a higher volume of transactions combined with the effect of higher spreads due to lower securitization funding rates. Credit fees were $19 million higher due to pricing initiatives in Commercial Banking. Investment administration fees were $5 million higher reflecting the increased market values of customer portfolios compared to the prior year as equity markets increased as well as increased sales of investment products.

Net gains (losses) on AFS and other securities were $54 million better than the same quarter in 2008, mainly reflecting OTTI of $49 million recorded in 2008 on non-bank ABCP designated as AFS. Trading revenue of $21 million was $60 million lower in the fourth quarter of 2009 compared to the same period in the prior year, which benefited from volatile interest and foreign exchange markets and the favourable impact of foreign currency funding in a lower interest rate environment. Other net mark-to-market accounting gains and losses include changes in the value of our own debt obligations designated at fair value, US$ funding of US$ denominated AFS securities where the corresponding translation gains or losses are recorded in shareholders' equity through accumulated other comprehensive income and derivatives used for hedging purposes. Other net mark-to-market accounting gains of $8 million in the fourth quarter of 2009 decreased by $15 million compared to the same period in 2008 due to the adverse impact of tightening credit spreads on the fair value of our own debt, partially offset by the effect of changes in interest rates on derivatives used for hedging purposes and the positive impact of strengthening of the Canadian dollar compared to the US dollar on US$ denominated funding of US$ denominated AFS securities.

Non-interest revenue in the fourth quarter of 2009 was $77 million or 40.5 per cent higher than the third quarter of 2009. Trading revenues increased by $36 million mainly as a result of the impact of the credit rating downgrade on certain of the Master Asset Vehicle ("MAV") notes of $42 million recorded in the third quarter. Capital market fees increased by $23 million due to higher client trading volumes resulting from increased equity markets and from higher structuring and advisory fees. Securitization income was $15 million higher due to an increased volume of transactions combined with the impact of higher spreads due to lower securitization funding rates. The effect of losses on AFS and other securities was $12 million better due to the impact of OTTI recorded on certain mortgage-backed securities in the third quarter. Credit fees increased by $6 million resulting from pricing initiatives in commercial banking. Investment administration fees increased by $3 million reflecting a gradual recovery in client investment balances due to higher equity markets. Other non-interest revenue was $9 million lower due to lower income from credit cards as well as loan insurance products.

Non-interest expenses and operating efficiency

Non-interest expenses of $292 million in the fourth quarter of 2009 were $3 million lower than the same period in 2008. Salaries and employee benefits were $16 million higher, reflecting increased variable compensation from higher capital markets activities partially offset by lower staff costs from a reduced number of employees together with the impact of a reduction in pension and benefit expense in 2008 resulting from the release of a valuation allowance previously applicable to pension plan assets. Other non-interest expenses were $20 million lower due to decreased commodity tax provisions, transaction related costs and information technology expenses, as well as the impact of cost control measures. The cost efficiency ratio in the fourth quarter of 2009 improved to 44.2 per cent from 49.3 per cent in the same period in 2008.

Non-interest expenses in the fourth quarter of 2009 were little changed from the third quarter of 2009. Salaries and employee benefits were $11 million lower mainly due to lower stock-based compensation arising from a reduction in the value of recent awards, as well as the impact of lower vesting of awards than anticipated. Other expenses were $11 million higher reflecting a normalized level of expenditures compared to the previous quarter. The cost efficiency ratio improved to 44.2 per cent from 52.2 per cent in the third quarter.

Income taxes

The effective tax rate in the fourth quarter of 2009 was 28.7 per cent, which compares to 23.8 per cent in the same quarter of 2008 and 29.3 per cent in the third quarter of 2009. The tax rate was higher in the fourth quarter of 2009 compared to the same period in 2008 primarily due to the release of a pension plan allowance in 2008 which is not taxable as well as the impact in 2008 of lower taxes on future income. The tax rate was lower in the fourth quarter of 2009 compared to the third quarter due to the recognition of increased income earned in the British Columbia international finance centre which is not subject to provincial income tax.

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

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

We set out details of how we apply certain accounting policies, including changes, in note 1 on pages 52 to 59. The following discussion sets out areas where we believe the selection and application of our accounting policies and the use of estimates and the application of judgement, could have a material impact on our reported results. We believe that our estimates are appropriate in the circumstances where applied.

Credit losses and estimation of allowances for credit losses

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

The allowance for credit losses consists of both specific and general impairment allowances, each of which is reviewed on a regular basis. Specific allowances are recorded on a loan-by-loan basis for those loans where we believe the ultimate collectibility of all or a portion of the principal and interest is in doubt. General impairment allowances are our best estimate of incurred losses for groups of individually significant loans for which no evidence of impairment has been individually identified or for high volume groups of homogeneous loans that are not considered individually significant.

The impaired loans and allowances sections in the MD&A on pages 31 to 33 and note 1(f) and (g) on pages 53 and 54 provide further details of the estimation of our impairment allowances.

We continually update economic factors in our assessments of potential specific loan loss allowances as well as any adjustments that may be required to the amount of the provision for general allowance for loan losses. During 2009, the level of economic uncertainty resulted in a considerable increase in the provision for credit losses compared with 2008 and prior years.

Employee future benefits

As part of employee compensation, the bank provides employees with pension and other post-retirement benefits, such as extended health care, to be paid after employees retire. All new employees participate in a defined contribution pension plan; therefore, there is a lower sensitivity toward adverse economic factors than might be the case for a defined benefit only plan. In certain cases, the amount of the final benefit may not be determined until some years into the future, particularly for defined benefit pensions, where the payment is based on a proportion of final salary and upon years of service. Although we contribute to several pension plans to provide for employee entitlements, the actual amount of assets required depends upon a variety of factors such as the investment return on plan assets, the rate of employee pay raises, and the number of years over which the ultimate pension is to be paid.

Due to the long-term nature of the contribution and payment periods for defined benefit plans, changes in long-term rates could have a material impact on our reported financial results. After consultation with our actuaries, we make certain assumptions regarding the long-term rate of investment return on pension plan assets, the discount rate applied to accrued benefit obligations, the rates of future compensation increases and the trends in health care costs. The assumptions we use and an analysis of the sensitivity of those assumptions on our benefits expense and accrued benefit obligations are set out in note 25 on pages 89 to 91. The most significant impact is a change in the discount rate applied to accrued benefit obligations. Under current accounting standards, the discount rate to be applied is a long-term bond rate rather than the estimated future performance of plan assets.

Management's Discussion and Analysis (continued)

Funding requirements for the bank's defined benefit pension plans are based on formal triennial actuarial valuations. Decreases in the value of plan assets experienced in 2008 will only be reflected in the bank's funding requirements when the next actuarial valuation is completed, although the partial recoveries experienced by plan values during 2009 are expected to lessen the impact. During 2009, only one of the bank's plans was subject to an actuarial valuation, which, following the significant downturns in equity markets in 2008, resulted in a small deficiency, requiring a small increase in the bank's funding in 2009. In addition, as a result of an existing small funding deficiency in one subsidiary's plan, an additional funding contribution was also made due to lower than expected returns since the previous valuation. As a result of expected legislative changes, it is anticipated that all the bank's plans will be subject to annual actuarial valuations in 2010 and subsequent years. As a result of lower than expected investment returns since previous valuations, the bank expects an increase in funding requirements for 2010. Although the additional required contribution will not be known until the valuations are completed later in 2010, the bank expects to be able to meet any additional funding requirements in full.

In 2009, the bank recognized a small decrease in the valuation allowance of approximately $2 million compared to a decrease of $11 million in 2008, which resulted in an increased pension expense. The allowance is calculated annually by our actuaries. The main reason for the decrease in the valuation allowance in 2009 was a reduction in the discount rate used to value obligations.

Income taxes

In establishing the income tax provision and the amount of the net future income tax asset recorded in our consolidated financial statements, we estimate the rates at which our income will be taxed in a variety of jurisdictions in Canada as well as expectations regarding dates of reversal of temporary differences. If the actual amounts, timing, or rates differ from the estimates or our interpretations of the tax legislation differ from those of the federal and provincial tax authorities, adjustments may be necessary. Details of our income tax provisions and net future income tax assets are set out in note 26 on page 92.

Goodwill and intangible assets

We review goodwill and intangible assets, including internally generated computer software, for impairment at least annually, to ensure that the fair values are in excess of carrying values. In determining fair value of goodwill and intangible assets, we use a variety of factors such as market comparisons, discount rates, price/earnings ratios and income estimates. The determination of values requires management judgement in the assumptions used as well as an appropriate method for determination of fair value. Any impairment in goodwill or intangible assets is charged to non-interest expense in the consolidated income statements. Although there were indicators of market weaknesses during 2009, the carrying amount of our goodwill was not impacted by these weaknesses. In addition, the operating segments to which the goodwill relates continued to be profitable during the year and there was no indication that, at December 31, 2009, there was any impairment in the carrying value of goodwill.

Securitizations and variable interest entities

As part of our liquidity, funding and capital management processes, we pool various types of consumer loans and transfer security interests in these loans to various securitization conduits. These securitizations, which are governed by purchase and sale contracts, are generally conducted through securitization conduits which are Special Purpose Variable Interest Entities ("VIEs") and financed by investors either through commercial paper or a longer-term investment.

Accounting policies for securitizations are set out in note 1(r) on page 57. If the accounting requirements for sales treatment are met, we recognize in income, at the time of the transfer, the present value of the excess spread we expect to earn over the life of the transaction, net of any estimated credit losses and transaction costs. This requires us to make assumptions regarding the expected cash flows of the loans securitized, including the amount of credit losses, discount rates and future servicing liabilities. To the extent that cash flows including the impact of credit losses vary from our estimates, adjustments to the carrying value of retained interests may be necessary. On a regular basis, we review the carrying value of the retained interests recorded within the consolidated financial statements for OTTI. Any OTTI is recorded in our consolidated income statements as a reduction of other income.

Our obligations to cover first losses in excess of these estimated credit losses are not provided for in the balance sheet. Information on our securitizations, including our assumptions and an analysis of the sensitivity of those assumptions on income, regarding loan repayment rates, estimated credit losses and maximum obligations under first loss protection provisions, is set out in note 5 on page 66.

Fair values of financial instruments

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

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

Information on the fair value of financial instruments is set out in note 1(d) on pages 52 and 53 and note 18 on pages 75 to 79.

The majority of our HFT and AFS securities are either issued or guaranteed by Canadian Federal and Provincial governments. Changes in the fair value of these securities are included in accumulated other comprehensive income.

Changes in Accounting Policies in 2009

Goodwill and intangible assets

Effective January 1, 2009, Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064, *Goodwill and Intangible Assets*, replaced CICA Handbook Sections 3062, *Goodwill and Other Intangible Assets*, and 3450, *Research and Development Costs*. Section 3064 provides guidance on the definition of an intangible asset and the recognition of internally generated intangible assets.

The application of this standard did not have a material impact on the bank's financial position and results of operations. However, as a result of adopting this standard, certain computer software with a net book value of $54 million at December 31, 2008 was reclassified from computer equipment (included in "Land, buildings and equipment") to intangible assets (included in "Other assets"), and the corresponding amortization of $12 million for 2008 was reclassified from "Premises and equipment" to "Other non-interest expense."

Financial instruments

In January 2009, the CICA issued Abstract 173 ("EIC-173"), *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*, which requires entities to take into account their own credit risk and the credit risk of counterparties when determining the fair value of certain financial assets and financial liabilities, including derivative instruments. EIC-173 was effective March 31, 2009 and was required to be applied retrospectively without restatement. The application of this abstract did not have a material impact on the bank's financial position and results of operations.

In June 2009, the CICA issued amendments to Section 3862, *Financial Instruments – Disclosures*, to require enhanced disclosures about fair value measurements of financial instruments and liquidity risk, including classification and disclosure of fair value measurements based on a three-level hierarchy. The bank has included these additional disclosures in note 18 on pages 75 to 79.

In August 2009, the CICA issued amendments to CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, effective for annual financial statements relating to fiscal years beginning on or after November 1, 2008, with early adoption permitted in the third quarter of 2009. The amendments permit investments in debt instruments that are not quoted in an active market to be classified as loans and receivables, with impairment assessed using the incurred credit-loss model of CICA Handbook Section 3025, *Impaired Loans*. Reversals of impairment losses on AFS debt instruments are required in subsequent periods when the fair value increase can be objectively related to an event occurring after the impairment loss was recognized. On transition, debt instruments may be transferred from the AFS category to the HTM or loans and receivables categories at amortized cost less impairment measured in accordance with Section 3025. The bank did not reclassify any of its debt instruments or reverse any impairment losses as a result of adopting these amendments in the third quarter of 2009.

Management's Discussion and Analysis (continued)

Future Accounting and Reporting Changes

Business combinations

In January 2009, the CICA issued Section 1582, *Business Combinations*, Section 1601, *Consolidations*, and Section 1602, *Non-Controlling Interests*. Section 1582 provides clarification of the measurement and valuation of a business acquired and the date at which the valuation should be determined. Unlike the existing standard, acquisition costs, except those associated with issuing debt or share capital, are expensed as incurred. Sections 1601 and 1602 establish standards for the preparation of consolidated financial statements and the accounting and presentation of non-controlling interests following a business combination. The new standards are effective for business acquisitions completed after January 1, 2011; however adoption in 2010 is permitted in order to facilitate the transition to International Financial Reporting Standards ("IFRS") in 2011.

In August 2009, the CICA issued conforming amendments to Section 1625, *Comprehensive Revaluation of Assets and Liabilities* and Section 3251, *Equity* as a result of issuing Sections 1582, 1601 and 1602 as noted above.

Transition to IFRS

The Canadian Accounting Standards Board previously announced that for fiscal years commencing on or after January 1, 2011, all publicly accountable enterprises will be required to report financial results in accordance with IFRS. The purpose of adopting IFRS is to promote the comparability of worldwide financial reporting. Accordingly, all interim and annual financial reporting, including comparative figures, will be prepared in accordance with IFRS from January 1, 2011 onwards.

HSBC Holdings, our ultimate parent, adopted IFRS in 2005. Accordingly for a number of years, we have been reporting our results on an IFRS basis for inclusion in the HSBC Group's consolidated financial results.

A subsidiary of a parent already reporting under IFRS on initial adoption of IFRS locally may align its reported financial results with those internally reported to its parent, or it may adopt IFRS independently from its parent. We have taken the decision to align our future locally reported IFRS results with the results internally reported to our ultimate parent for inclusion in the HSBC Group's consolidated financial results.

Governance

We have formed an IFRS implementation steering committee to provide appropriate governance consisting of senior management, accounting policy, subject matter experts and subsidiary representatives. The IFRS implementation steering committee reports to the Audit Committee and OSFI on a regular basis.

Our strategy and progress

We have developed an implementation strategy and timetable for our transition to enhance our present IFRS reporting process. Our transition to IFRS for local reporting will build on the existing HSBC Group IFRS reporting process.

During 2009, we completed our detailed assessment of accounting differences between Canadian GAAP and IFRS. We have not identified any material accounting differences which are not addressed by our present processes and systems, however, certain changes are still necessary and in progress. We have begun preparations to determine our opening IFRS balance sheet as at January 1, 2010, which will be our starting point for accounting under IFRS. We plan to base our Canadian IFRS financial statements on the HSBC Group's Annual Report. As a result of reporting our financial results on an IFRS basis for inclusion in the HSBC Group's consolidated financial results, a number of accounting staff are experienced in applying IFRS. However, we plan to assess training needs of the remainder of our staff during 2010 and to provide appropriate training where necessary. Management believes that it has made available sufficient resources to successfully complete the transition.

Expected impact of IFRS on our financial processes and information systems

Our financial systems are able to process and report financial information on an IFRS basis. In the third quarter of 2009, we modified certain of our accounting systems to further improve the timeliness of reporting under IFRS for internal purposes, as well as laying the groundwork for implementing a fully integrated IFRS based accounting system. In addition, prior to the adoption of IFRS we plan to replace one of our core financial reporting systems which will give us an enhanced ability to report financial results using various GAAP standards, including IFRS.

Expected impact of IFRS on our financial reporting

We have identified the items that will have an impact on our financial results reported under IFRS, the most of significant of which are presented below. We plan to disclose the financial impact of transitioning of these items when we have finalized our consolidated opening balance sheets at January 1, 2010 under IFRS.

Securitization
A securitization transaction can be accounted for as either a sale or a secured borrowing under both Canadian GAAP and IFRS. If the securitization transaction is accounted for as a sale, the financial asset is removed (or derecognized) from the consolidated balance sheets and a gain or loss is recorded in non-interest revenue based on the carrying value of the financial asset transferred. If the securitization transaction is accounted for as a secured borrowing, the transferred financial assets remain recognized on the consolidated balance sheets and a corresponding liability is recognized for the funds received.

The bank securitizes certain mortgage-backed securities under the Canadian Mortgage and Housing Corporation's ("CMHC") Canada Mortgage Bond and Insured Mortgage Purchase Program. Under Canadian GAAP, the securitization is accounted for as a sale because there is no control over the assets transferred. Under IFRS, the securitization is accounted for as a secured borrowing because the bank is required to make scheduled principal and interest payments although it may not collect these cash flows from the securitized assets.

In addition, the bank securitizes certain mortgages using non-CMHC third party securitization conduits. Under Canadian GAAP, the securitization is accounted for as a sale because there is no control over the assets transferred. Under IFRS, the securitization of these financial assets is accounted for as a secured borrowing because the bank substantially retains all risk and rewards associated with ownership.

Under Canadian GAAP, certain securitization transactions are accounted for as a sale and consequently, some securitized assets are removed from the consolidated balance sheets and a profit or loss is realized. However, under IFRS, all of the bank's current securitization transactions are accounted for as secured borrowings and consequently, all securitized assets remain on the consolidated balance sheets and a liability is recognized for funds received.

Employee defined benefit plans
Under Canadian GAAP, the bank follows the 'corridor approach' in recognizing actuarial gains and losses under its defined benefit plans. Under this approach, the excess of net actuarial gains and losses over 10 per cent of the greater of the accrued benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees covered under the plan in question. The amortized amounts are recognized in the consolidated statements of income.

Under IFRS, in order to align its accounting policy with the HSBC Group, the bank will recognize all actuarial gains and losses, as they are incurred, in shareholders' equity.

In addition, as permitted by Canadian GAAP, the bank uses September 30 as the measurement date for plan assets and employee obligations for accounting purposes. Under IFRS, entities are required to use their year-end date as the measurement date.

Financial instruments
We have hedging strategies and formally documented hedging relationships in place under Canadian GAAP and IFRS respectively. The majority of hedging relationships allowed under Canadian GAAP are also allowed under IFRS. However, certain interest rate swap transactions related to our securitization programs are not recognized under IFRS.

Foreign exchange on AFS securities
The bank owns certain foreign currency AFS securities. Under Canadian GAAP, foreign exchange gains or losses on these securities are recognized in shareholders' equity, within accumulated OCI, while under IFRS foreign exchange adjustments on AFS securities are recognized in the income statement.

Future IASB projects and our assumed impacts
Several standards are in the process of being amended by the IFRS standard setter, the International Accounting Standards Board ("IASB"). Amendments to existing standards are expected to continue until our IFRS adoption date of January 1, 2011. The bank actively monitors the IASB's schedule of projects, giving consideration to any proposed changes, where applicable, in its assessment of differences between IFRS and Canadian GAAP.

Management's Discussion and Analysis (continued)

Off-Balance Sheet Arrangements

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

Guarantees and letters of credit

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

For credit risk management purposes, we consider guarantees and letters of credit as part of our clients' credit facilities, which are subject to appropriate risk management procedures. Guarantees and letters of credit are considered part of our overall credit exposure, as set out in the analysis of our loan portfolio on page 29 of the MD&A, and as set out in note 30 on pages 96 to 98.

Derivative financial instruments

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

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

We use derivatives to limit our exposure to interest rate risk on loans and deposits with differing maturity dates, or foreign currency assets and liabilities of differing amounts. Mismatches in currency or maturity dates could expose us to significant financial risks if there are adverse changes in interest rates or foreign exchange rates. The use of derivatives is subject to strict monitoring and internal control procedures as set out in our risk management discussion in the MD&A on pages 25 to 39.

Our accounting policies on recording the impact of derivatives are set out in note 1(p) on pages 56 and 57. Quantitative information on our derivative instruments is set out in note 19 on pages 80 to 84.

Disclosure Controls and Procedures and Internal Control over Financial Reporting

Management's responsibility for financial information contained in our Annual Report is set out on page 46.

Disclosure controls and procedures

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

As of December 31, 2009, management evaluated, under the supervision and with the participation of the CEO and the CFO, the effectiveness of our disclosure controls and procedures as defined by the Canadian securities regulatory authorities under National Instrument 52-109. Based on that evaluation, the CEO and the CFO have concluded that the design and operation of these disclosure controls and procedures are effective as of December 31, 2009.

Internal control over financial reporting

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements in accordance with GAAP. Management is responsible for establishing and maintaining adequate internal control over financial reporting. These controls include those policies and procedures that: pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the bank; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the bank are being made only in accordance with authorizations of management and directors of the bank; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the bank's assets that could have a material effect on the annual financial statements. Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis. Furthermore, projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has evaluated, under the supervision of and with the participation of the CEO and the CFO, the design and effectiveness of the internal control over financial reporting as required by the Canadian securities regulatory authorities under National Instrument 52-109. This evaluation was performed using the framework and criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that internal control over financial reporting was effective as at December 31, 2009.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting during the year ended December 31, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Related Party Transactions

We enter into transactions with other HSBC affiliates as part of the normal course of business, such as banking and operational services. In particular, as a member of one of the world's largest financial services organizations, we share in the expertise and economies of scale provided by the HSBC Group. We provide and receive services or enter into transactions with a number of HSBC Group companies, including sharing in the cost of development for technology platforms used around the world and benefit from worldwide contracts for advertising, marketing research, training and other operational areas. These related party transactions are on terms similar to those offered to non-related parties and are subject to formal approval procedures that have been approved by the bank's Conduct Review Committee.

In 2008, we completed the acquisition of HSBC Financial from another HSBC Group company. As part of the acquisition, we obtained an independent valuation of HSBC Financial, with the fair value of the company acquired approximating the book value as at the date of acquisition. For further information, refer to note 2 on pages 59 to 61.

Fees are charged by HSBC Group with respect to guarantees of deposits and medium-term notes, and administrative and technical services provided to us. For 2009, the total amount we expensed related to fees paid to other HSBC Group companies in respect of these transactions was $118 million (2008 – $109 million).

Fees are received from HSBC Group companies with respect to administrative and technical services provided by us. The total fees received for the year amounted to $16 million (2008 – $6 million) and were recorded in non-interest revenue.

Included in non-interest revenue were fees of $20 million (2008 – $23 million) received from an HSBC Group company arising from the sale of credit life, accident, disability, health and unemployment insurance policies relating to customer borrowings.

Management's Discussion and Analysis (continued)

There are also a number of routine transactions occurring during the course of the year, none of which are individually material to our results. Reference should also be made to note 14 on page 71 and note 29 on page 96.

Dividends

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

	2009	2008	2007
Preferred Shares Class 1 ($ per share)			
Series C	**$ 1.275**	$ 1.275	$ 1.275
Series D	**1.250**	1.250	1.250
Series E[(1)]	**1.201**	–	–
Preferred Shares Class 2 ($ per share)			
Series B	**0.310**	0.025[(2)]	–
HSBC HaTS™ ($ per unit)			
Series 2010	**77.80**	77.80	77.80
Series 2015	**51.50**	51.50	51.50
Common Shares ($ millions)			
HSBC Bank Canada	**280**	270	260
HSBC Financial Corporation Limited	**–**	50	50[(3)]

(1) *Dividends will be $1.65 per share in a full year.*
(2) *Declared in 2008 and paid in 2009.*
(3) *Declared in 2007 and paid in 2008.*

Credit Ratings

Standard & Poor's ("S&P") and DBRS® maintain credit ratings of our debt and securities. The ratings are made within the rating agencies' normal classification system for each type of debt or security. Our credit ratings influence our ability to secure cost-efficient wholesale funding.

Following a review by S&P of the hybrid capital securities of various European banks, including those of the bank's ultimate parent, HSBC Holdings, there was a consequential downgrade in the ratings of our preferred shares and HSBC Canada Asset Trust securities. In addition, as a result of a change in their ratings methodology, DBRS® downgraded the ratings on preferred shares and hybrid securities of a number of Canadian banks, including those of HSBC Bank Canada.

Investment grade ratings on our short-term instruments, deposits, senior debt and subordinated debt are unchanged from 2008 and remain among the highest assigned to the Canadian banks.

Our ratings at December 31, 2009 were as follows:

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

(1) *On December 19, 2008 S&P revised its outlook for the bank from stable to negative in conjunction with a similar revision in the outlook of HSBC Holdings and other HSBC subsidiaries.*
(2) *On March 3, 2009 DBRS® revised its trends on our ratings from stable to negative in conjunction with a similar revision to the ratings trends on HSBC Holdings and other HSBC subsidiaries.*
(3) *Based on S&P's Canadian national preferred share scale. Ratings are 'A' on S&P global preferred share scale.*

Capital Management

Objectives, policies and processes

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

To ensure our processes are appropriately governed and to meet our objectives, we enforce policies approved by the Board and HSBC Holdings. The bank's Asset and Liability Committee ("ALCO") has overall responsibility for capital management. It is chaired by our CFO and includes the CEO, Deputy Chief Executive Officer, and our senior executives responsible for credit, risk management, marketing and sales, treasury and capital management. The Capital Governance Group ("CGG"), also chaired by the CFO, reports to ALCO and is responsible for managing the formal governance over the bank's Internal Capital Adequacy Assessment Process ("ICAAP"). The mandate of the CGG is to ensure the bank's Capital Management and Governance structure is supported by robust policies and methodologies which ensure that the bank has sufficient capital to support all material risks to which it is exposed. It is responsible for ensuring the bank's overall capital is aligned with its risk management framework, assessing risk in comparison to the risk profile and strategic objectives set by ALCO and ensuring actual and planned levels of capital are adequate in relation to the bank's risk profile in the current and potential economic environment in which it operates. ICAAP uses various risk measurement tools, including economic capital models and stress testing techniques to ensure that the bank's capital is adequate to meet current and future risks and to achieve its strategic objectives.

An annual capital plan is prepared and approved by the Board and HSBC Holdings with the objective of ensuring that the level of capital supply from both regulatory and economic capital viewpoints:

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

Our Finance and Treasury Departments manage compliance with our policies daily, with monthly monitoring by ALCO.

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

– Establishing appropriate risk-based financial metrics and targets which relate capital to risk;
– Assessing capital adequacy in the context of its current position and various expected scenarios;
– Active senior management monitoring and control; and
– Regular Board oversight.

Capital adequacy regulations

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

OSFI regulates capital adequacy for Canadian federally incorporated financial institutions including banks. OSFI's regulations are based on international standards set by the Bank for International Settlements ("BIS"). Although BIS sets minimum limits for financial institutions to maintain 4 per cent and 8 per cent Tier 1 and total capital ratios (as a percentage of risk-weighted assets), respectively, OSFI recommends Canadian banks maintain minimum Tier 1 and total capital ratios of 7 per cent and 10 per cent, respectively. The bank maintained ratios that satisfied these requirements in both 2009 and 2008.

Management's Discussion and Analysis (continued)

Capital framework in the calculation of capital ratios

The bank 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 the HSBC Group, has adopted the Advanced Internal Ratings Based ("AIRB") approach for calculating capital requirements for credit risk. The AIRB approach allows the bank to use internal estimates for certain risk measures, including probability of default ("PD"), loss given default ("LGD"), exposure at default ("EAD") and effective maturity for calculating risk-weighted assets for credit risk. This, compared to the treatment under the Basel I accord, aligns regulatory capital requirements more closely with the risk profile of the business. For operational risk, a new requirement of the Basel II framework, the bank has adopted the Standardized Approach. Operational risk capital is required to cover the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Under the Standardized Approach, the capital required is calculated by applying a specific factor, ranging from 12 per cent to 18 per cent, to the gross income of specific business lines.

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

In December 2009, the Basel Committee on Banking Supervision issued two consultative papers which are intended to strengthen global capital and liquidity regulations. It is anticipated that following the consultation period, these proposals will be finalized by December 31, 2010, with implementation expected by December 31, 2012.

The liquidity proposals include providing supervisory expectations on the key elements of a robust framework for liquidity risk management and enhancements and standardization of liquidity monitoring and measurements.

The capital proposals significantly revise the definitions of regulatory capital (Tier 1 and Tier 2), with an elimination of certain instruments that currently qualify as Tier 1 regulatory capital. The proposals also emphasize common equity as the predominant component of Tier 1 capital by adding a minimum common equity to risk-weighted assets ratio.

The bank's core common equity is existing Tier 1 capital less non-controlling interest in subsidiaries, innovative Tier 1 capital instruments and preferred shares. At December 31, 2009 the bank's core common equity as a percentage of risk-weighted assets was 8.5 per cent (2008 – 7.4 per cent).

Regulatory capital ratios

The components of our regulatory capital and our actual regulatory capital ratios are stated in the table below. As mentioned above, we adopted a revised Basel II framework as of January 1, 2008 that changes how capital ratios are calculated.

The Canada Deposit Insurance Corporation ("CDIC") has a tiered, differential insurance premium ratings system, which includes targets for capital adequacy. One of the other measures CDIC uses in determining whether a financial institution is well capitalized is an asset to regulatory capital multiple as defined by CDIC. This definition regards a financial institution as being well capitalized if it maintains an assets to regulatory capital multiple of less than OSFI's maximum permitted assets-to-capital multiple. The bank targets to be prudently below this threshold and has met the asset to capital multiple test comfortably in both 2009 and 2008.

	2009 **(*Basel II*)**	2008 (*Basel II*)
Tier 1 capital	$ **4,567**	$ 4,197
Tier 2 capital	**1,041**	1,004
Total Tier 1 and Tier 2 capital available for regulatory purposes	**$ 5,608**	$ 5,201
Total risk-weighted assets	**$ 37,674**	$ 41,623
Actual regulatory capital ratios		
Tier 1 capital	**12.1%**	10.1%
Total capital	**14.9%**	12.5%
Actual assets-to-capital multiple	**12.9x**	14.0x
Minimum regulatory capital ratios required		
Tier 1 capital	**7.0%**	7.0%
Total capital	**10.0%**	10.0%

Risk Management

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

All of our business activities involve the measurement, evaluation, acceptance and management of some degree of risk, or combinations of risks. Risk management is the identification, analysis, evaluation and management of the factors that could adversely affect our resources, operations, reputation and financial results. The most important risk categories that we are exposed to include credit, liquidity and funding, market, structural, fiduciary and operational risks. The management of these various risk categories is discussed below. The risk management framework established seeks an integrated evaluation of risks and their interdependencies to foster the continuous monitoring of the risk environment.

Risk governance

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

- Identifying significant risks and measurement thereof;
- Developing and recommending for approval appropriate risk management policies and procedures to identify, assess and control material risks on an enterprise wide basis, including business continuity planning;
- Providing direction regarding our overall risk philosophy and appetite, including the acceptability of new, modified or unusual risk and ensuring risk appetite is appropriately aligned with local, regional and global conditions;
- Ensuring business risk is balanced against economic return;
- Monitoring adherence to risk management policies and procedures; and
- Reporting any policy or major practice change, unusual situations, significant exceptions, new strategy or products to our Executive Committee and where appropriate to the Audit Committee and the Board for review, ratification and/or approval.

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

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

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

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

Credit risk

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

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

Management's Discussion and Analysis (continued)

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

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

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

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

Policies and procedures

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

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

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

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

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

We manage real estate lending within well-defined parameters with an emphasis on relationship and project sponsorship for all new transactions. We are actively managing the exposure level and composition of this portfolio given its concentration in our credit portfolio. Where we are dependent upon third parties for establishing asset values, consistent and transparent valuations are ensured through maintaining a list of approved professionals that meet our standards.

Credit risk rating framework

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

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

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

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

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

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

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

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

Stress testing and sensitivity analysis

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

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

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

Maximum exposure to credit risk

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

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

Management's Discussion and Analysis (continued)

	2009	2008
On-balance sheet exposure		
Cash held at Bank of Canada and other regulated financial institutions	**$ 1,897**	$ 1,855
Securities		
As disclosed on balance sheet	**14,709**	10,818
Less: Equity securities not exposed to credit risk	**(155)**	(189)
Securities purchased under reverse repurchase agreements	**8,496**	6,682
Loans	**38,104**	43,646
Customers' liability under acceptances	**4,966**	5,209
Derivatives	**1,100**	2,448
Included within other assets		
Accrued interest receivable	**154**	177
Interest earning other assets	**222**	175
Due from clients, dealers and clearing corporations	**815**	306
Accounts receivable and other	**477**	427
Total on-balance sheet exposure	**70,785**	71,554
Off-balance sheet exposure		
Financial and performance standby letters of credit	**2,249**	2,570
Documentary and commercial standby letters of credit	**228**	397
Commitments to extend credit	**36,229**	37,426
Credit and yield enhancement	**13**	14
Total off-balance sheet exposure	**38,719**	40,407
Maximum exposure	**$ 109,504**	$ 111,961

Collateral and other credit enhancements

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

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

The principal collateral types are as follows:

- In the personal sector, mortgages over residential properties or charges over other personal assets being financed;
- In the commercial and industrial sector, charges over business assets such as land, buildings and equipment, inventory and receivables;
- In the commercial real estate sector, charges over the properties being financed; and
- In the financial sector, charges over financial instruments such as debt and equity securities in support of trading facilities.

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

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

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

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

Loan portfolio diversity

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

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

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

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

	2009	2008
Loans included in financial statements, net of allowances	**$ 38,104**	$ 43,646
Allowance for credit losses	**638**	615
Customers' liabilities under acceptances(1)	**4,966**	5,209
Financial and performance standby letters of credit(1)	**2,249**	2,570
Documentary and commercial letters of credit	**228**	397
Total loans	**46,185**	52,437
Impaired loans and other impaired credit exposures(1)	**(1,022)**	(932)
Total performing loans	**$ 45,163**	$ 51,505

(1) *Includes $15 million (2008 – $5 million) of impaired acceptances and letters of credit.*

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

Performing loan portfolio

	2009		2008	
Business and government loans(1)	**$ 25,547**	**56.6%**	$ 31,183	60.5%
Residential mortgages	**10,889**	**24.1**	11,204	21.8
Consumer finance loans	**3,023**	**6.7**	3,848	7.5
Other consumer loans	**5,704**	**12.6**	5,270	10.2
Total performing loans	**$ 45,163**	**100.0%**	$ 51,505	100.0%

(1) *Includes $408 million (2008 – $628 million) of construction and other loans secured by mortgages over residential property.*

Geographic distribution

	2009		2008	
British Columbia	**$ 20,141**	**44.6%**	$ 21,295	41.3%
Western Canada, excluding British Columbia	**9,394**	**20.8**	11,022	21.4
Ontario	**10,336**	**22.9**	12,905	25.1
Quebec and Atlantic	**5,292**	**11.7**	6,283	12.2
Total performing loans	**$ 45,163**	**100.0%**	$ 51,505	100.0%

Business and government loan portfolio by industry

	2009		2008	
Real estate	**$ 8,119**	**31.8%**	$ 9,730	31.2%
Services	**4,970**	**19.5**	5,851	18.8
Trade	**3,264**	**12.8**	4,462	14.3
Manufacturing	**2,814**	**11.0**	3,543	11.4
Hotels and hospitality	**899**	**3.5**	1,004	3.2
Other	**5,481**	**21.4**	6,593	21.1
Total business and government loans	**$ 25,547**	**100.0%**	$ 31,183	100.0%

Large customer concentrations are borrowing groups where approved facilities exceed 10 per cent of our regulatory capital base. At December 31, 2009, this amount was approximately $561 million (2008 – $520 million).

Management's Discussion and Analysis (continued)

The following table provides details of our large customer concentrations:

	2009	2008
Large customer concentration	**$ 2,363**	$ 2,737
As a percentage of business and government loans	**9.2%**	8.8%
As a percentage of total performing loans	**5.2%**	5.3%

Credit quality of financial assets

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

For core banking operations, the vast majority of the total loan portfolio is categorized as strong. Credit quality of the portfolio was historically stable until the latter part of 2007. Credit quality has deteriorated through the decline in this credit cycle. We expect this to continue into 2010, although there are signs that economic recovery is on the horizon. At December 31, 2009, $846 million, or 2.0 per cent, of the loan portfolio was impaired, compared to $751 million, or 1.6 per cent, at December 31, 2008, with specific and general allowances providing 52 per cent (2008 – 56 per cent) coverage of these loans. Overall credit quality remains satisfactory, reflecting our prudent lending standards. Provision levels overall remained stable compared to the prior year.

For our Consumer Finance segment, the impaired loans of $176 million at December 31, 2009 were lower than the $181 million at December 31, 2008, primarily due to the credit tightening measures implemented in 2007 and thereafter. However, impaired loans relative to the total receivables portfolio were 5.5 per cent at December 31, 2009, compared to 4.5 per cent at December 31, 2008, primarily due to a declining receivables base and weaker economic conditions. At December 31, 2009, the general allowances provided 114 per cent coverage of the impaired loans (2008 – 108 per cent). On a year over year basis, while overall credit quality may have deteriorated as a result of weakening economic conditions, including higher bankruptcy and higher unemployment levels, results for 2009 were better than expected.

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

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

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

Credit quality of non-retail portfolio

	2009 (EAD)			2008 (EAD)		
	Drawn	*Undrawn*	*Total*	*Drawn*	*Undrawn*	*Total*
Strong	**$ 19,330**	**$ 4,063**	**$ 23,393**	$ 16,836	$ 3,889	$ 20,725
Medium	**24,916**	**7,633**	**32,549**	29,500	8,462	37,962
Sub-standard	**1,533**	**167**	**1,700**	1,427	178	1,605
Impaired	**723**	**44**	**767**	912	81	993
	$ 46,502	**$ 11,907**	**$ 58,409**	$ 48,675	$ 12,610	$ 61,285

Credit quality of retail portfolio (excluding Consumer Finance segment)

	2009 (EAD)			2008 (EAD)[1]		
	Drawn	*Undrawn*	*Total*	*Drawn*	*Undrawn*	*Total*
Strong	**$ 11,212**	**$ 1,014**	**$ 12,226**	$ 10,764	$ 1,098	$ 11,862
Medium	**12,630**	**2,842**	**15,472**	11,950	2,741	14,691
Sub-standard	**693**	**70**	**763**	709	100	809
Impaired	**190**	**–**	**190**	138	–	138
	$ 24,725	**$ 3,926**	**$ 28,651**	$ 23,561	$ 3,939	$ 27,500

(1) *Balances have been reclassified to reflect a change in the pooling methodology, which was approved by OSFI in the first quarter of 2009.*

Credit quality of retail portfolio (Consumer Finance segment)

	2009	2008
	Drawn	*Drawn*
Strong	**$ 1,461**	$ 1,381
Medium	**1,104**	1,950
Sub-standard	**468**	578
Impaired	**176**	181
	$ 3,209	$ 4,090

Renegotiated loans

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

The carrying amount of loans that would otherwise be past due or impaired whose terms have been renegotiated was $9 million at December 31, 2009 (2008 – $5 million).

Loans past due but not impaired

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

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

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

	2009	2008
Past due up to 29 days	**$ 450**	$ 597
Past due 30–59 days	**132**	168
Past due 60–89 days	**59**	65
Past due 90 days and over	**29**	9
	$ 670	$ 839

Impaired loans and allowance for credit losses

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

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

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

Management's Discussion and Analysis (continued)

Assessing the adequacy of the allowance for credit losses is inherently subjective as it requires making estimates that may be susceptible to significant change. This includes the amount and timing of expected future cash flows and incurred losses for loans that are not individually identified as being impaired.

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

– Known cash flow difficulties experienced by the borrower;

– Past due contractual payments of either principal or interest;

– Breach of loan covenants or conditions;

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

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

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

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

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

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

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

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

The following table provides details of the impaired loan portfolio:

	2009	2008
Business and government		
Real estate	**$ 439**	$ 452
Manufacturing[1]	**98**	143
Trade	**64**	30
Services	**67**	39
Other	**78**	24
Total business and government loans	**746**	688
Personal		
Residential mortgages	**62**	37
Consumer finance loans	**176**	181
Other consumer loans	**38**	26
Total personal loans	**276**	244
Total impaired loans, acceptances and letters of credit[1]	**$ 1,022**	$ 932
Specific allowances	**$ 186**	$ 162
General allowances	**452**	453
Total allowance for credit losses	**$ 638**	$ 615
Net impaired loans and acceptances	**$ 384**	$ 317

(1) *Includes $15 million (2008 – $5 million) of impaired acceptances and letters of credit.*

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

	2009	2008
Real estate	**8%**	12%
Manufacturing	**54%**	43%
Other[1]	**46%**	51%
Total	**25%**	23%

(1) *Includes business and government loans.*

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

Coverage by general allowance[1]

	2009	2008
As a percentage of total performing loans	**1.00%**	0.88%
As a percentage of risk-weighted assets	**1.20%**	1.09%

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

Provisions for credit losses

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

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

	2009	2008
Specific provisions	**$ 260**	$ 130
Collective provisions	**255**	249
Total provision for credit losses	**$ 515**	$ 379
Specific provisions as a percentage of total loan portfolio	**0.56%**	0.25%

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

For our Consumer Finance segment, general provisions increased by $10 million in 2009 to reflect the higher levels of write-offs and higher delinquency in the portfolio.

Management's Discussion and Analysis (continued)

Impaired securities

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

Asset-backed commercial paper

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

In 2009, as a result of proceedings with respect to loan foreclosures and restructurings, we acquired restructured notes with a par value of $135 million from borrowers. The notes were initially recognized at their fair value of $81 million, resulting in credit losses of $40 million being recorded. Following initial recognition and measurement, the notes were classified as HFT and are being accounted for consistently with the bank's other restructured notes.

The par value of the bank's restructured notes at December 31, 2009, including the repossessed notes described above was $459 million, with a carrying value of $256 million. At December 31, 2008, the carrying amount of non-bank ABCP was $212 million. In the current year, as a result of changes in market conditions, the fair value of the restructured notes decreased by $20 million, which was recognized as a reduction in trading revenue. The recorded net carrying value of the restructured notes represents management's best estimate of the fair value of the restructured notes at December 31, 2009.

For further information on the Plan and the determination of the fair value of our non-bank ABCP, refer to note 3 on pages 61 to 64.

AFS securities

Certain investments in preferred shares, mutual funds and debt securities experienced significant declines in market value in relation to their original cost. As a result, a charge for OTTI of $20 million was recorded during 2009 as a loss on AFS securities (2008 – $8 million).

Derivative portfolio

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

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

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

	2009	2008
Interest rate contracts	**$ 641**	$ 816
Foreign exchange contracts	**1,259**	2,024
Net credit equivalent amount	**$ 1,900**	$ 2,840

A more detailed analysis of our derivative portfolios is presented in note 19 on pages 80 to 84.

Liquidity and funding risk

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

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

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

Policies and procedures

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

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

Our liquidity and funding management process includes:

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

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

Primary sources of funding

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

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

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

As part of our wholesale funding arrangements, we have a number of programs for fundraising activities, including asset securitizations and facilities with major Canadian institutional lenders and borrowers, so that undue reliance is not placed on any one source of funding.

As part of the HSBC Group’s worldwide liquidity and funding management process, we have established limits for balance sheet ratios and minimum periods of forecast positive cumulative cash flow as well as contingencies to meet cash flow needs. As part of these contingencies, we can access the considerable resources of the HSBC Group and currently have a US$500 million standby borrowing facility from our US affiliate, although no amounts have been drawn from this facility since its inception in 1997.

Management's Discussion and Analysis (continued)

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

	2009			
	On demand and due within 3 months	*Due between 3 and 12 months*	*Due between 1 and 5 years*	*Due after 5 years*
Deposits	$ 35,788	$ 7,446	$ 7,068	$ 629
Acceptances	4,834	132	–	–
Interest bearing liabilities of subsidiaries, other than deposits	879	1,176	1,396	–
Derivatives	897	–	–	–
Securities sold under repurchase agreements	1,079	1,438	–	–
Securities sold short	1,148	–	–	–
Subordinated debentures(1)	109	29	134	882
Other financial liabilities	1,484	174	723	–
	$ 46,218	$ 10,395	$ 9,321	$ 1,511
Loan commitments	22,106	13,452	65	606
	$ 68,324	$ 23,847	$ 9,386	$ 2,117

(1) *Excludes interest payable exceeding 15 years.*

Certain balances in the above table will not agree directly to the balances in the consolidated balance sheets as the table incorporates cash flows for both principal and interest, on an undiscounted basis, except for derivatives. Furthermore, loan commitments are not recognized on the balance sheet. Derivatives have been classified as "On demand and due within three 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 three months include personal savings and personal and commercial notice accounts of $26 billion.

Contractual obligations

As part of our normal business operations we have contractual obligations for payment of liabilities. Amounts included in unsecured long-term funding in the table below are wholesale term deposits with an original term to maturity of more than one year, based on contractual repayment dates. Also included are obligations related to commitments not recorded in the consolidated balance sheets, such as those relating to operating leases.

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

	2009				
	Less than 1 year	*1 to 2 years*	*3 to 4 years*	*After 5 years*	*Total*
Subordinated debentures(1)	$ 100	$ –	$ –	$ 729	$ 829
Operating leases	56	91	78	125	350
Committed purchase obligations	96	89	45	2	232
Unsecured long-term funding(1)	1,186	1,307	329	29	2,851
Total contractual obligations	$ 1,438	$ 1,487	$ 452	$ 885	$ 4,262

(1) *Includes principal amounts only.*

Committed purchase obligations include long-term arrangements for the provision of technology and data processing services by HSBC Group companies. Not included in the table are any commitments relating to customers utilizing undrawn portions of their loan facilities. As a result of our ongoing funding and liquidity management process which we monitor regularly, we expect to be able to meet all of our funding and other commitments in the normal course of our operations despite the economic uncertainty.

Market risk

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

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

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

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

Policies and procedures

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

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

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

Value at Risk

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

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

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

The historical simulation models used incorporate the following features:

- Potential market movements are calculated with reference to data from the past two years;
- Historical market rates and prices are calculated with reference to foreign exchange rates and commodity prices, interest rates, equity prices and the associated volatilities;
- VaR is calculated to a 99 per cent confidence level; and
- VaR is calculated for a one-day holding period.

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

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

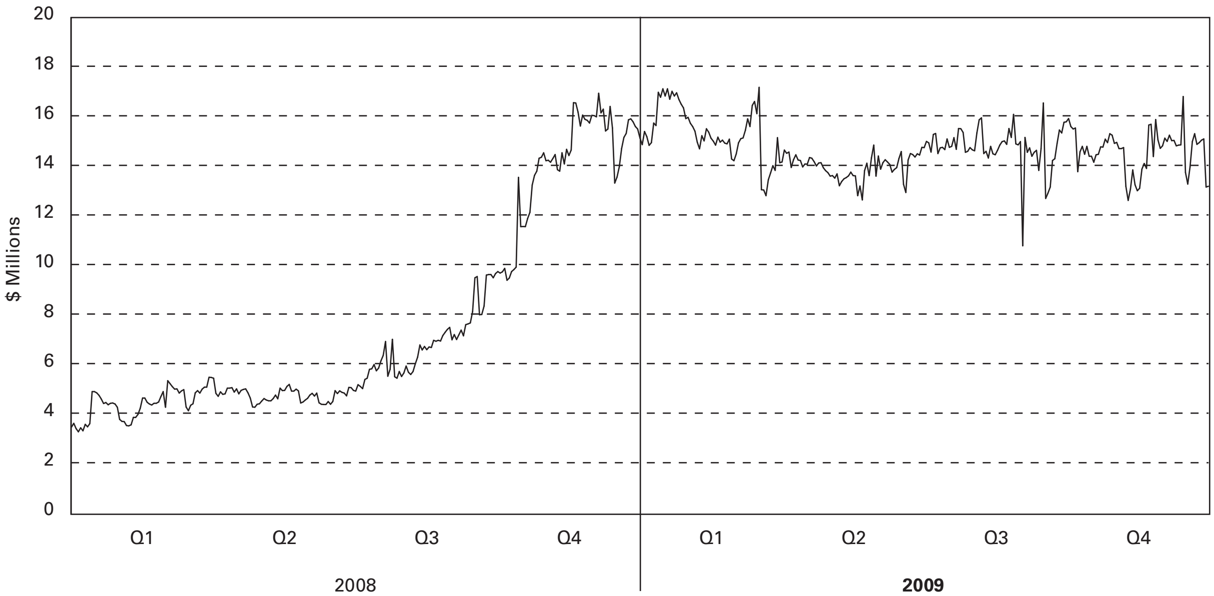
- The use of historical data as a proxy for estimating future events may not encompass all potential events, particularly those which are extreme in nature;
- The use of a one-day holding period assumes that all positions can be liquidated or hedged in one day, which may not fully reflect the market risk arising at times of severe illiquidity, when a one day holding period may be insufficient to liquidate or hedge all positions fully;
- The use of a 99 per cent confidence level, by definition, does not take into account losses that might occur beyond this level of confidence;
- VaR is calculated on the basis of exposures outstanding at the close of business and therefore does not necessarily reflect intra-day exposures; and
- VaR is unlikely to reflect loss potential on exposures that only arise under significant market moves.

Management's Discussion and Analysis (continued)

VaR disclosed in the table and graph below is the bank's total VaR for both trading and non-trading financial instruments. The information presented below does not include the results of HSBC Financial because the subsidiary employed other methods to measure and manage market risk prior to acquisition. (Refer to note 2 on pages 59 to 61 for additional information).

Daily Value at Risk

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



Summary Value at Risk information

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

		2009		2008
End of year	**$**	**13**	$	15
Average		**15**		7
Minimum		**11**		4
Maximum	**$**	**17**	$	17

The increase in Average and Minimum VaR results from the inclusion of high market volatility in late 2008 and early 2009, which remains in the 500-day historical data set used to determine VaR. Risk appetite as determined by the level of interest rate sensitivity was fairly stable throughout the year. VaR levels remained within our approved limits throughout 2009.

Structural risk

Structural risk is the impact of interest rate and foreign exchange rate risks on assets and liabilities included in the banking book, including those in our consolidated balance sheets. We value instruments included in the banking book at cost plus accrued interest (the effective interest rate method) and changes in rates and prices will not directly impact earnings. However, to the extent that assets and liabilities are not directly matched either by interest or exchange rates, any changes in the mix of assets or liabilities will affect earnings.

Interest rate risk

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

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

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

In managing interest rate risk, we rely primarily upon our contractual interest rate sensitivity position adjusted for assumptions regarding customer behavior. Adjustments made include assumptions relating to early repayment of consumer loans and residential mortgages and customer preferences for demand, notice and redeemable deposits. Based upon these adjustments made to our contractual positions, it is estimated that an immediate and sustained parallel increase in interest rates of 1 per cent across all currencies and maturities would increase net interest income by $62 million (2008 – increase of $37 million) over the next twelve months assuming no additional hedging is undertaken.

Foreign exchange risk

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

Operational risk

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

We have policies for managing operational risk and aim to minimize loss through a framework requiring all business units to identify, assess, monitor and control operational risk. Operational risks are identified by the units and presented to the Operational Risk & Internal Control Committee which has the responsibility of challenging the risk identification and control strategies proposed, as well as the actions being taken to mitigate the risk. This operational risk management process is subject to a review by our Risk Management Committee and approval by our Board.

We manage operational risk through disciplined application and evaluation of internal controls, appropriate segregation of duties, independent authorization of transactions, and regular, systematic reconciliation and monitoring of transactions. We have a dedicated function that proactively manages our compliance process, and we maintain high ethical standards. These processes together with our control structure help ensure that our exposure to operational risk is managed. This control structure is complemented by independent and periodic reviews by our Internal Audit department.

As part of the enterprise-wide risk management process, we have established business continuity and event management practices so we can continue to service our customers' needs in the event of major business disruption. Back-up facilities in various cities across North America increase our recovery capabilities for key businesses.

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

Operational risk also encompasses fiduciary risk. Generally speaking, a fiduciary is a person who owes certain duties to another person including a duty of loyalty, care and disclosure. A fiduciary relationship is a legal concept and only arises in certain circumstances such as between a trustee or executor and beneficiary. Fiduciary risk is the risk of a person failing to identify the existence of a fiduciary relationship and to meet the applicable duties. The Fiduciary Risk Management Committee, a sub-committee of the Risk Management Committee, is charged with assisting various businesses with known fiduciary relationships to understand, identify and satisfy their fiduciary obligations and to help assess and identify other relationships, businesses or activities that may expose the bank or its subsidiaries to potential fiduciary or fiduciary-like risk.

Management's Discussion and Analysis (continued)

Analysis of Financial Results and Operations by Customer Group

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

A summary of the breakdown of selected consolidated financial information and other data by major customer groups is included in note 28 on pages 94 to 96.

Personal Financial Services

Business developments and achievements for 2009 include:

- *Deposit and mortgage products* – We continue to support our customers, growing personal and broker deposits to $25.2 billion, up by $1.6 billion or 7 per cent for the year, and residential mortgages were down by $0.5 billion, or 4 per cent, to $11.4 billion.
- *Premier* – We continued to grow our Premier customer base, attracting over 49,900 customers, of which 34 per cent were new to the bank. At year end, HSBC Bank Canada was home to over 151,000 Premier customers, a growth of 49 per cent from the prior year. HSBC Premier offers seamless global banking with over 6,000 Premier branches worldwide in over 40 countries.
- *Funds under management* – The investment performance and capabilities at HSBC Global Asset Management were well recognized in Canada throughout 2009. HSBC Global Asset Management received Globefund's four star awards for the HSBC AsiaPacific Fund, HSBC BRIC Equity Fund, HSBC Chinese Equity Fund, HSBC Small Cap Growth Fund and HSBC LifeMap Aggressive Growth Portfolio.
- *Direct Bank* – Our Advance Savings Account (formerly Direct Savings Account) continues to grow, achieving $2.4 billion in deposits by year-end with over 907,000 customers. HSBC InvestDirect introduced on-line customer access to three new international stock exchanges (London, Euronext Paris and Frankfurt stock exchanges). Together with our existing access to the Hong Kong exchange this makes it Canada's most international direct investing site.
- *Product innovations* – We continued to bring innovative products to the Canadian market, launching the HSBC Smart Saver Mortgage™, which connects customers' savings account to their mortgage, reducing their interest costs.

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

	2009	2008
Net interest income	**$ 357**	$ 395
Non-interest revenue	**291**	265
Total revenue	**648**	660
Non-interest expenses	**550**	569
Net operating income	**98**	91
Provision for credit losses	**42**	21
Income before taxes and non-controlling interest in income of trust	**56**	70
Provision for income taxes	**16**	19
Non-controlling interest in income of trust	**5**	6
Net income	**35**	45
Preferred share dividends	**7**	4
Net income attributable to common shares	**$ 28**	$ 41
Percentage of total net income	**6.9%**	7.6%
Average assets	**$ 18,290**	$ 19,401
Percentage of total average assets	**25.5%**	26.2%

Results for 2009 were impacted by a loss of $16 million arising from the sale of the auto business in 2008 and a $21 million write-down on non-bank ABCP and 2008 included a $29 million loss from the sale of the auto business and a $24 million write-down on non-bank ABCP. Excluding these items, income before taxes and non-controlling interest in income of trust, was $93 million, a decrease of $30 million, or 24 per cent, compared with $123 million for 2008.

Net interest income was $357 million, a decrease of $38 million, or 10 per cent, compared with $395 million for 2008. This is primarily due to spread compression related to competitive pricing on retail deposits and the low interest rate environment. Balances in GICs and term deposits declined as customers transitioned to more liquid products like High Rate Savings Accounts. Mortgage prepayment penalties have increased due to a higher number of mortgage refinancings at lower rates.

Excluding the non-bank ABCP write-downs and the loss on the sale of the auto business, underlying non-interest revenue increased by $10 million in 2009, or 3 per cent, driven by higher securitization income, and higher security and bond commissions attributable to higher trading volumes, partially offset by lower foreign exchange revenue and lower investment administration fees due to a decrease in the average value of managed funds during the year.

Non-interest expenses of $550 million decreased by $19 million, or 3 per cent, compared with $569 million for 2008. The decrease was largely attributable to lower incentive compensation, lower commission expenses related to lower variable revenues, reversals of commodity tax provisions, additional commodity tax recoveries and lower training expenses, partially offset by higher global resourcing costs due to a higher number of migrations and increased rent and computer equipment costs.

The provision for credit losses, which includes a $9 million allocation of a credit loss on non-bank ABCP exposures, was $21 million higher compared to 2008 due to increased write-offs and delinquencies as a result of the deteriorated credit environment and higher unemployment rates, and an update to the provisioning methodology made in 2008.

Commercial Banking

Business developments and achievements for 2009 include:

– *Best Bank for Small Business* – We launched BusinessVantage, a bundled product with an innovative pricing model and new smart-form technology, and the BusinessVantage MasterCard. We launched Business Direct and the HSBC Business Centre to serve clients who desire the features and benefits of a virtual branch environment. We invested in training for our Business Banking employees to equip them with necessary knowledge and skills to provide professional advice to our clients.

– *Leading International Business* – We created a North American international business team focused specifically on becoming the leader in market share for businesses who do business internationally. Our team has been working collaboratively with HSBC offices in the USA and in Europe and has successfully established relationships with businesses that have cross-border needs.

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

	2009	2008
Net interest income	**$ 692**	$ 694
Non-interest revenue	**245**	181
Total revenue	**937**	875
Non-interest expenses	**304**	317
Net operating income	**633**	558
Provision for credit losses	**223**	130
Income before taxes and non-controlling interest in income of trust	**410**	428
Provision for income taxes	**101**	118
Non-controlling interest in income of trust	**16**	16
Net income	**293**	294
Preferred share dividends	**18**	11
Net income attributable to common shares	**$ 275**	$ 283
Percentage of total net income	**58.1%**	49.6%
Average assets	**$ 24,249**	$ 26,912
Percentage of total average assets	**33.9%**	36.4%

Income before taxes and non-controlling interest in income of trust was $410 million, a decrease of $18 million, or 4 per cent, compared with $428 million for 2008. The results for 2009 included a $20 million write-down on non-bank ABCP compared to $25 million in 2008.

Management's Discussion and Analysis (continued)

Net interest income was $692 million and remained relatively flat compared to the prior year. Net interest margin on loans increased due to wider Canadian Prime to bankers' acceptance rates and repricing initiatives. This was offset by lower lending volumes, as clients deleveraged and lower net interest margins on deposits arising from a lower interest rate environment.

Non-interest revenue increased by $64 million, or 35 per cent, to $245 million in 2009 as repricing initiatives resulted in growth of service charge revenues and fees on banker's acceptances and other credit-related products. This was partially offset by lower foreign exchange revenues and wire commissions, as client volumes were impacted by reduced levels of international trade.

Non-interest expenses were $304 million, a decrease of $13 million, or 4 per cent, due to lower variable compensation expenses and cost control initiatives.

The provision for credit losses increased by $93 million to $223 million due to higher levels of impaired loans in the real estate, trade and service sectors as a result of weak credit and economic conditions.

Global Banking and Markets

Business developments and achievements for 2009 include:

- *Revenue Growth* – Total revenue grew 9 per cent, largely on increased capital markets revenues and net mark-to-market accounting gains.
- *Global Corporate Banking* – We leveraged our Global Banking and Markets international presence, building relationships with target clients in resource, energy, infrastructure and financial sectors. Our joined up approach continued to lead to a substantial increase in lead roles on cross-border debt financing for target clients. We were engaged on six mergers and acquisitions advisory mandates in the financial and energy sectors.
- *Debt Capital Markets* – We led or co-led nine transactions raising a total of $1.3 billion for domestic and foreign issuers and participated in 143 transactions raising a total of $101 billion for domestic and foreign issuers.
- *Equity Capital Markets* – We participated in 131 transactions raising $29 billion.
- *Asset Management* – In 2009, we successfully launched the Premier-branded World Selection investment service in Canada. World Selection will be offered to HSBC customers across Europe, the Middle East and Asia-Pacific. Also in 2009, the HSBC Indian Equity Fund was introduced in Canada. This new fund complements the already popular HSBC Chinese Equity Fund, HSBC BRIC Equity Fund and HSBC Emerging Markets Fund, ensuring HSBC now has the broadest line up of emerging market funds across Canada.

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

	2009	2008
Net interest income	**$ 53**	$ 78
Non-interest revenue	**396**	333
Total revenue	**449**	411
Non-interest expenses	**136**	122
Net operating income	**313**	289
Provision for credit losses	**12**	–
Income before taxes and non-controlling interest in income of trust	**301**	289
Provision for income taxes	**100**	82
Non-controlling interest in income of trust	**5**	4
Net income	**196**	203
Preferred share dividends	**5**	3
Net income attributable to common shares	**$ 191**	$ 200
Percentage of total net income	**38.8%**	34.2%
Average assets	**$ 25,626**	$ 22,759
Percentage of total average assets	**35.7%**	30.8%

Income before taxes and non-controlling interest in income of trust was $301 million compared with $289 million in 2008, an increase of $12 million, or 4 per cent. The results included losses related to non-bank ABCP of $23 million in 2009 compared to $24 million in 2008.

Net interest income decreased by $25 million, or 32 per cent, in 2009 to $53 million reflecting lower net interest margins, higher funding and liquidity costs and dislocated financial markets.

Non-interest revenue increased by $63 million, or 19 per cent, to $396 million. In 2009 Global Investment Banking revenues grew due to the increase in market activities and included a $23 million gain recognized as part of a transaction to raise unsecured term funding. Certain AFS securities were sold in 2009, resulting in a realized gain of $27 million being recognized. Other net mark-to-market accounting gains were higher due to translation gains recorded on US dollar funding of US dollar AFS securities, higher mark-to-market gains on derivatives used to hedge certain of our interest rate exposures where hedge accounting was not applied, partially offset by the negative impact of tightening credit spreads on the value of our own debt and negative hedge ineffectiveness incurred on our cash flow hedge portfolio. Additionally, trading revenues decreased due to lower customer volumes for foreign exchange products.

Non-interest expenses increased by $14 million to $136 million due to higher variable compensation costs and general and administrative costs.

The provision for credit losses was $12 million higher mainly due to certain non-bank ABCP exposures.

Consumer Finance

Business developments and achievements for 2009 include:

– *Reduced risk in business* – As a result of anticipated weakening economic conditions, we tightened underwriting criteria for all products including reductions in real estate loan-to-value ratios for first and second lien mortgages. We strengthened collections by increasing staffing and investing in analytics. As a result, delinquency performance during this difficult economic cycle was significantly better than expected.

– *Cost containment* – As a result of reduced business volumes, we continued our focus on cost containment. During 2009, the branch network of HSBC Financial was reduced from 93 to 76 branches. We also continued our efforts to join up our organization with HSBC affiliates in North America and HSBC Global Service Centres around the world.

– *Retail strategy* – We reduced our merchant base during 2009 as a result of strategic reviews on profitability and strategic fit.

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

	2009	2008
Net interest income	**$ 377**	$ 477
Non-interest revenue	**19**	58
Total revenue	**396**	535
Non-interest expenses	**187**	222
Net operating income	**209**	313
Provision for credit losses	**238**	228
(Loss) income before taxes and non-controlling interest in income of trust	**(29)**	85
(Recovery of) provision for income taxes	**(10)**	34
Non-controlling interest in income of trust	**–**	–
Net (loss) income	**(19)**	51
Preferred share dividends	**27**	2
Net (loss) income attributable to common shares	**$ (46)**	$ 49
Percentage of total net (loss) income	**(3.8)%**	8.6%
Average assets	**$ 3,530**	$ 4,880
Percentage of total average assets	**4.9%**	6.6%

Management's Discussion and Analysis (continued)

Consumer Finance recorded a loss before taxes of $29 million in 2009, compared to income before taxes of $85 million in 2008.

Net interest income was $377 million, a decrease of $100 million, or 21 per cent, compared with $477 million for 2008. As a result of ongoing credit tightening decisions commencing in the fourth quarter of 2007 in anticipation of a difficult economic environment, we experienced lower loan volumes in our core businesses. In addition, we sold our auto finance portfolio of approximately $330 million in mid-2008, which also impacted net interest income. Accordingly, average receivables declined by approximately $1.0 billion, or 22 per cent, including the sale of the auto finance business, resulting in lower net interest income in 2009 when compared to 2008.

Non-interest revenue decreased by $39 million, or 67 per cent, in 2009, from $58 million in 2008. Net losses on AFS securities were $19 million (2008 – nil), due to an OTTI charge being recorded on certain mortgage-backed securities. In 2009, we also recorded a $4 million charge relating to a loss guarantee on our auto portfolio. Excluding these items, non-interest revenue decreased by $15 million, largely resulting from the lower receivable base but partially offset by higher credit card revenue.

Non-interest expense declined by $35 million, or 16 per cent, in 2009 due to lower staff costs, incentives and lower business volumes. Marketing expenses decreased as there were fewer marketing campaigns in 2009 due to continued credit tightening initiatives.

The provision for credit losses increased by $10 million, or 4 per cent, in 2009. While write-offs increased in 2009, loan loss reserves increased by $7 million in 2009 compared with $33 million in 2008, reflecting the higher velocity of delinquency experienced during 2008 when compared to 2009.

Consolidated Financial Statements

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Statement of Management's Responsibility for Financial Information

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

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

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

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

As at December 31, 2009, we, the bank's Chief Executive Officer and Chief Financial Officer, have certified the effectiveness of our internal control over financial reporting as defined by the Canadian Securities Administrators under National Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings).

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

Lindsay Gordon
President and Chief Executive Officer

Graham A. McIsaac, FCA
Chief Financial Officer

Vancouver, Canada
February 15, 2010

Auditors' Report

To the Shareholders of HSBC Bank Canada

We have audited the consolidated balance sheets of HSBC Bank Canada as at December 31, 2009 and 2008 and the consolidated statements of income, changes in shareholders' equity, comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the management of HSBC Bank Canada. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of HSBC Bank Canada as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Vancouver, Canada
February 15, 2010

Consolidated Balance Sheets

At December 31 *(in millions of dollars)*

	2009	2008
Assets		
Cash resources:		
Cash and non-interest bearing deposits with the Bank of Canada and other banks	**$ 652**	$ 434
Deposits with regulated financial institutions	**1,245**	1,421
	1,897	1,855
Securities: (note 3)		
Available-for-sale	**12,682**	9,683
Held-for-trading	**1,986**	1,079
Other	**41**	56
	14,709	10,818
Securities purchased under reverse repurchase agreements	**8,496**	6,682
Loans: (note 4)		
Business and government	**18,442**	23,067
Residential mortgages	**11,359**	11,869
Consumer finance loans	**3,199**	4,029
Other consumer loans	**5,742**	5,296
Allowance for credit losses	**(638)**	(615)
	38,104	43,646
Other:		
Customers' liability under acceptances	**4,966**	5,209
Derivatives (note 19)	**1,100**	2,448
Land, buildings and equipment (note 6)	**142**	126
Other assets (note 7)	**1,923**	1,265
	8,131	9,048
	$ 71,337	$ 72,049
Liabilities and Shareholders' Equity		
Deposits: (note 8)		
Regulated financial institutions	**$ 754**	$ 1,264
Individuals	**21,578**	21,064
Businesses and governments	**27,875**	29,634
	50,207	51,962
Other:		
Acceptances	**4,966**	5,209
Interest bearing liabilities of subsidiaries, other than deposits (note 9)	**3,324**	4,164
Derivatives (note 19)	**897**	2,023
Securities sold under repurchase agreements	**2,517**	715
Securities sold short	**1,148**	631
Other liabilities (note 10)	**2,650**	1,974
Non-controlling interest in trust and subsidiary (note 11)	**430**	430
	15,932	15,146
Subordinated debentures (note 12)	**834**	788
Shareholders' equity:		
Capital stock (note 13)		
Preferred shares	**946**	696
Common shares	**1,225**	1,225
Contributed surplus	**7**	–
Retained earnings	**2,113**	1,950
Accumulated other comprehensive income	**73**	282
	4,364	4,153
	$ 71,337	$ 72,049

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

Approved on behalf of the Board of Directors:

Sam Minzberg

Samuel Minzberg
Chairman of the Audit Committee

Lindsay Gordon

Lindsay Gordon
President and Chief Executive Officer

Consolidated Statements of Income

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

	2009	2008
Interest income:		
Loans	**$ 1,986**	$ 3,016
Securities	**275**	288
Deposits with regulated financial institutions	**14**	94
	2,275	3,398
Interest expense:		
Deposits	**637**	1,520
Interest bearing liabilities of subsidiaries, other than deposits	**120**	195
Subordinated debentures	**39**	39
	796	1,754
Net interest income	**1,479**	1,644
Non-interest revenue:		
Deposit and payment service fees	**110**	112
Credit fees	**165**	124
Capital market fees	**153**	88
Investment administration fees	**117**	130
Foreign exchange	**41**	49
Trade finance	**24**	24
Trading revenue	**95**	162
Gains (losses) on available-for-sale and other securities (note 3(c))	**8**	(66)
Securitization income	**102**	87
Other	**67**	80
Other mark-to-market accounting gains, net	**69**	47
	951	837
Total revenue	**2,430**	2,481
Non-interest expenses:		
Salaries and employee benefits	**642**	644
Premises and equipment, including amortization	**165**	153
Other	**370**	433
	1,177	1,230
Net operating income before provision for credit losses	**1,253**	1,251
Provision for credit losses (note 4)	**515**	379
Income before provision for income taxes and non-controlling interest in income of trust	**738**	872
Provision for income taxes (note 26)	**207**	253
Non-controlling interest in income of trust	**26**	26
Net income	**$ 505**	$ 593
Preferred share dividends (note 13)	**57**	20
Net income attributable to common shares	**$ 448**	$ 573
Average number of common shares outstanding (000's)	**498,668**	524,042
Basic earnings per common share	**$ 0.90**	$ 1.09

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

Consolidated Statements of Changes in Shareholders' Equity

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

	2009	2008
Preferred shares: (note 13)		
Balance at beginning of year	**$ 696**	$ 350
Issued	**250**	346
Balance at end of year	**946**	696
Common shares: (note 13)		
Balance at beginning of year	**1,225**	1,293
Recapitalization (note 2)	**–**	(68)
Balance at end of year	**1,225**	1,225
Contributed surplus:		
Balance at beginning of year	**–**	232
Stock-based compensation (note 24)	**7**	7
Recapitalization (note 2)	**–**	(239)
Balance at end of year	**7**	–
Retained earnings:		
Balance at beginning of year	**1,950**	1,736
Net income	**505**	593
Preferred share dividends (note 13)	**(57)**	(20)
Common share dividends (note 13)	**(280)**	(320)
Share issue costs	**(5)**	–
Recapitalization (note 2)	**–**	(39)
Balance at end of year	**2,113**	1,950
Accumulated other comprehensive income (loss) – available-for-sale securities:		
Balance at beginning of year	**85**	1
Net change in unrealized (losses) gains on available-for-sale securities, net of income taxes	**(110)**	84
Balance at end of year	**(25)**	85
Accumulated other comprehensive income (loss) – cash flow hedges:		
Balance at beginning of year	**197**	–
Net change in cash flow hedges, net of income taxes	**(99)**	197
Balance at end of year	**98**	197
Total accumulated other comprehensive income	**73**	282
Total shareholders' equity	**$ 4,364**	$ 4,153

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

Consolidated Statements of Comprehensive Income

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

	2009	2008
Net Income	**$ 505**	$ 593
Other comprehensive income on available-for-sale securities:		
Net unrealized (losses) gains from changes in fair value (net of income taxes of $(47), $34)	**(99)**	70
Reclassification of realized (losses) gains to earnings (net of income taxes of $(7), $6)	**(11)**	14
	(110)	84
Other comprehensive income on cash flow hedges:		
Unrealized (losses) gains from changes in fair value (net of income taxes of $(46), $94)	**(99)**	197
Comprehensive income for the year	**$ 296**	$ 874

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

Consolidated Statements of Cash Flows

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

	2009	2008
Cash flows provided by (used in) operating activities:		
Net income	$ 505	$ 593
Adjustments to net income to determine net cash provided by operating activities:		
Amortization expense	46	46
Provision for credit losses (note 4)	515	379
Provision for impairment of available-for-sale securities	20	69
Future income taxes (note 26)	(56)	54
Net accrued interest receivable and payable	(24)	13
Trading securities	(907)	148
Derivatives, net	177	(181)
Mortgages sold with recourse	324	155
Securities sold short	517	8
Other, net	(153)	(72)
	964	1,212
Net cash flows provided by (used in) financing activities:		
Deposits (repaid) received	(1,755)	3,084
Interest bearing liabilities of subsidiaries, other than deposits	(840)	(1,018)
Securities sold under repurchase agreements	1,802	395
Proceeds from issue of preferred shares (note 13)	250	–
Dividends paid (note 13)	(339)	(388)
	(882)	2,073
Net cash flows provided by (used in) investing activities:		
Loans repaid (funded), excluding securitizations	1,311	(4,955)
Proceeds from loans securitized (note 5)	3,541	4,286
Proceeds from sale of loans	–	1,850
Loans purchased from securitization conduits	–	(1,062)
Non-trading securities purchased	(8,752)	(12,428)
Non-trading securities sold	1,739	1,483
Non-trading securities matured	3,996	6,334
Other securities	15	–
Securities purchased under reverse repurchase agreements	(1,814)	(560)
Net change in non-operating and other deposits with regulated financial institutions	177	1,711
Acquisition of land, buildings and equipment	(76)	(52)
	137	(3,393)
Increase (decrease) in cash and cash equivalents	219	(108)
Cash and cash equivalents, beginning of year	420	528
Cash and cash equivalents, end of year	$ 639	$ 420
Represented by:		
Cash and non-interest bearing deposits with the Bank of Canada and other banks	$ 652	$ 434
Less non-operating deposits with other banks[1]	(13)	(14)
Cash and cash equivalents, end of year	$ 639	$ 420
Supplementary cash flow information:		
Interest paid during the year	$ 843	$ 1,779
Income taxes paid during the year	$ 224	$ 364

(1) *Non-operating deposits comprise cash restricted for recourse on securitization transactions.*

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

Notes to Consolidated Financial Statements

December 31, 2009 and 2008 *(all tabular amounts are in millions of dollars unless stated otherwise)*

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

1 Accounting policies

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

a *Basis of consolidation*

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

b *Use of estimates and assumptions*

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

c *Cash resources*

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

d *Financial instruments*

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

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

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

d *Financial instruments (continued)*

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

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

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

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

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

e *Securities*

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

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

f *Loans*

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

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

Notes to Consolidated Financial Statements (continued)

1 Accounting policies *(continued)*

f *Loans (continued)*

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

g *Allowance for credit losses*

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

Assessing the adequacy of the allowance for credit losses is inherently subjective, as it requires making estimates that may be susceptible to significant change. This includes the amount and timing of expected future cash flows and incurred losses for loans that are not individually identified as being impaired.

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

Specific allowances are recorded on a loan-by-loan basis, for those loans where we believe the ultimate collectibility of all or some portion of principal or interest is in doubt, to reduce the carrying value of an impaired asset to its estimated realizable amount. The estimated realizable amount is determined by discounting the expected future cash flows at the EIR inherent in the loan at the date of impairment. The fair value of any collateral securing the loan, net of any expected realization costs or the observable market price for the loan may be used to measure the estimated realizable amount.

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

For consumer loans, residential mortgages and credit cards, expected losses are estimated through analysis of historical loss migration and write-off trends, supplemented by judgmental adjustments that employ an established framework and reference both internal and external indicators of credit quality.

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

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

h *Securities purchased and sold under repurchase agreements*

Where securities are sold subject to a commitment to repurchase them at a predetermined price, they remain on the consolidated balance sheets as guaranteed loans and borrowings and a liability is recorded in respect of the consideration received. Conversely, securities purchased under reverse repurchase agreements are not recognized on the consolidated balance sheets and an asset is recorded representing the consideration paid. Interest income on securities purchased under reverse repurchase agreements, and interest expense on securities sold under repurchase agreements are recorded using the EIR method.

1 Accounting policies *(continued)*

i *Obligations related to securities sold short*

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

j *Land, buildings and equipment*

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

k *Goodwill and other intangible assets*

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

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

Goodwill and other intangible assets are reviewed at least annually or more frequently if events or changes in circumstances indicate that the assets might be impaired, for indications of impairment to ensure that their fair value is greater than or equal to their carrying value. Any excess of carrying value over fair value is charged to income in the period in which impairment is determined.

l *Customers' liability under acceptances*

Acceptances represent a form of negotiable short-term debt that is issued by our customers and which we guarantee for a fee. We expect most acceptances to be settled simultaneously with the reimbursement from customers. Our exposure under acceptances is reported as a liability. Our recourse against customers is recorded as an equivalent offsetting asset. Fees earned are reported in credit fees in non-interest revenue.

m *Income taxes*

Income taxes are accounted for under the asset and liability method. Under this method, future income tax assets and liabilities are determined based on temporary differences (differences between the tax basis and accounting basis of assets and liabilities as well as any applicable operating losses and tax credit carry forwards) and are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability is settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment. A valuation allowance is recorded against any future tax asset if it is more likely than not that the asset will not be realized. Income tax expense or recovery is the sum of the provision for current income taxes and the difference between the opening and ending balances of the future income tax assets and liabilities, adjusted for any amounts included in other comprehensive income ("OCI").

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

n *Employee future benefits*

The bank accrues its obligations under employee benefit plans (including pension and other post-retirement plans) and the related costs, net of plan assets. The pension plans include both defined benefit and defined contribution plans. The post-retirement plans include supplemental pension arrangements that provide pension benefits in excess of the benefits provided by the pension plans, and post-retirement, non-pension arrangements that provide certain benefits in retirement. The pension plans are funded by contributions from us or our employees, while the supplemental pension arrangements are not funded.

1 Accounting policies *(continued)*

n *Employee future benefits (continued)*

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

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

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

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

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

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

o *Translation of foreign currencies*

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at prevailing year-end exchange rates. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the rates in effect at the transaction date. Realized and unrealized gains and losses from foreign currency translation are included in non-interest revenue, and presented in the consolidated statements of income, with the exception of unrealized foreign exchange gains and losses on AFS securities, which are included in AOCI, and presented in the statements of comprehensive income, until such time that they are realized and included in non-interest revenue.

Net gains or losses arising from translation of foreign denominated funding of foreign denominated AFS securities (where the corresponding translation gains or losses are recorded in equity through accumulated other comprehensive income) are included as part of "Other mark-to-market accounting gains, net" in the consolidated statements of income.

p *Derivative instruments and hedges*

Derivative instruments are contracts whose value is derived from an underlying asset or an underlying reference rate or index such as interest or foreign exchange rates. In the ordinary course of business, we enter into various derivative contracts, including interest rate, foreign exchange and equity forwards, futures, swaps and options. Derivative contracts are either exchange-traded contracts (including futures and options) or negotiated over-the-counter contracts (including forwards, swaps and options). We enter into such contracts for trading purposes, as well as to hedge our exposures to currency and interest rate fluctuations as part of our risk management program. Trading activities are undertaken to meet the needs of our customers, as well as on our own account to earn trading income, and on any contracts that do not qualify for hedge accounting.

Hedging derivative instruments, including derivatives which do not qualify for hedge accounting, are marked-to-market and the resulting net gains or losses are recognized in "Other mark-to-market accounting gains, net" in the consolidated statements of income.

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

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

p *Derivative instruments and hedges (continued)*

We formally document all relationships between hedging instruments and hedged items, as well as our risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to identified assets and liabilities or identified firm commitments or forecasted transactions. We also formally assess, at the hedge's inception, retrospectively and prospectively on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows attributed to the hedged risks.

Accrued interest receivable and deferred gains are recorded in other assets and accrued interest payable and deferred losses are recorded in other liabilities. Interest income or expense and amortized gains or losses are recorded in interest income or interest expense, as applicable.

Foreign exchange translation gains and losses on foreign currency-denominated derivative financial instruments used to hedge foreign currency exposures are accrued under other assets or other liabilities, and recognized in non-interest revenue, net of expenses, offsetting the respective translation losses and gains recognized on the underlying foreign currency exposures.

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

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

Cash flow hedges are used to manage the impact on income from the effects of changes in the interest rates on variable rate assets and liabilities. In a cash flow hedging relationship, the effective portion of the change in fair value of the hedging derivative will be recognized in OCI, while the ineffective portion is recognized in "Other mark-to-market accounting gains, net". The amounts recognized in OCI will be reclassified to net income in periods in which net income is affected by the variability in the cash flows of the hedged item.

q *Trust assets under administration*

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

r *Loan securitizations*

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

The fair values of loans sold, retained interests and recourse liabilities are determined using market values where appropriate or pricing models taking into account our best estimates of key assumptions such as expected losses, prepayments and discount rates commensurate with the risks involved, or sales of similar assets.

Retained interests, which are accounted for as AFS, are included in other assets and recorded at fair value. Retained interests are tested regularly for OTTI and carrying values reduced to reflect any such impairment in non-interest income. Where we continue to service the loans sold, a servicing liability or asset is recognized and amortized over the servicing period. Revenue earned in respect of servicing the assets sold is reflected in non-interest revenue as services are provided.

Notes to Consolidated Financial Statements (continued)

1 Accounting policies *(continued)*

s *Stock-based compensation*

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

t *Investment companies*

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

u *Variable interest entities*

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

v *Changes in accounting policies in 2009*

i) Goodwill and intangible assets

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

The application of this standard did not have a material impact on the bank's financial position and results of operations. However, as a result of adopting this standard, certain computer software with a net book value of $54 million at December 31, 2008 was reclassified from computer equipment (included in "Land, buildings and equipment") to intangible assets (included in "Other assets"), and the corresponding amortization of $12 million for 2008 was reclassified from "Premises and equipment" to "Other non-interest expense."

ii) Financial instruments

In January 2009, the CICA issued Abstract 173 ("EIC-173"), *Credit Risk and the Fair Value of Financial Assets and Financial Liabilities*, which requires entities to take into account their own credit risk and the credit risk of counterparties when determining the fair value of certain financial assets and financial liabilities, including derivative instruments. EIC-173 was effective March 31, 2009 and was required to be applied retrospectively without restatement. The application of this abstract did not have a material impact on the bank's financial position and results of operations.

In June 2009, the CICA issued amendments to Section 3862, *Financial Instruments – Disclosures*, to require enhanced disclosures about fair value measurements of financial instruments and liquidity risk, including classification and disclosure of fair value measurements based on a three-level hierarchy. The bank has included these additional disclosures in note 18 on pages 75 to 79.

In August 2009, the CICA issued amendments to CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, effective for annual financial statements relating to fiscal years beginning on or after November 1, 2008, with early adoption permitted in the third quarter of 2009. The amendments permit investments in debt instruments that are not quoted in an active market to be classified as loans and receivables, with impairment assessed using the incurred credit-loss model of CICA Handbook Section 3025, *Impaired Loan*s. Reversals of impairment losses on AFS debt instruments are required in subsequent periods when the fair value increase can be objectively related to an event occurring after the impairment loss was recognized. On transition, debt instruments may be transferred from the AFS category to the HTM or loans and receivables categories at amortized cost less impairment measured in accordance with Section 3025. The bank did not reclassify any of its debt instruments or reverse any impairment losses as a result of adopting these amendments.

1 Accounting policies *(continued)*

w *Future accounting and reporting changes*

i) Business combinations

In January 2009, the CICA issued Section 1582, *Business Combinations*, Section 1601, *Consolidations*, and Section 1602, *Non-Controlling Interests*. Section 1582 provides clarification of the measurement and valuation of a business acquired and the date at which the valuation should be determined. Unlike the existing standard, acquisition costs, except those associated with issuing debt or share capital, are expensed as incurred. Sections 1601 and 1602 establish standards for the preparation of consolidated financial statements and the accounting and presentation of non-controlling interests following a business combination. The new standards are effective for business acquisitions completed after January 1, 2011; however adoption in 2010 is permitted in order to facilitate the transition to International Financial Reporting Standards ("IFRS") in 2011. These new standards must be adopted concurrently.

In August 2009, the CICA issued conforming amendments to Section 1625, *Comprehensive Revaluation of Assets and Liabilities* and Section 3251, *Equity* as a result of issuing Sections 1582, 1601 and 1602 as noted above.

ii) Transition to IFRS

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

A description of the bank's implementation plan, progress and governance and the expected impact on our financial processes, systems and reporting is included in the Management's Discussion and Analysis on pages 18 and 19.

2 Business combination

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

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

The financial position and the results of operations of HSBC Financial were adjusted to conform with the accounting policies of the bank.

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

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

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

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

Notes to Consolidated Financial Statements (continued)

2 Business combination *(continued)*

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

	2008
Common shares	
As previously reported	$ 1,225
HSBC Financial common shares	68
As restated	$ 1,293
Contributed surplus	
As previously reported	$ 206
HSBC Financial contributed surplus	26
As restated	$ 232
Retained earnings	
As previously reported	$ 1,462
HSBC Financial retained earnings	274
As restated	$ 1,736
Accumulated other comprehensive income	
As previously reported	$ 5
HSBC Financial accumulated other comprehensive income	(4)
As restated	$ 1

The effect of the acquisition on the consolidated balance sheet and consolidated statement of income of the bank was as follows:

Consolidated Balance Sheet

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

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

2 Business combination *(continued)*

Consolidated Statement of Income

	2008		
	Pro-forma excluding HSBC Financial[1]	*Impact of HSBC Financial*	*Total*
Net interest income	$ 1,167	$ 477	$ 1,644
Non-interest revenue	779	58	837
Total revenue	1,946	535	2,481
Non-interest expense	1,008	222	1,230
Net operating income before provision for credit losses	938	313	1,251
Provision for credit losses	151	228	379
Income before provision for income taxes and non-controlling interest in income of trust	787	85	872
Provision for income taxes	219	34	253
Non-controlling interest in income of trust	26	–	26
Net income	$ 542	$ 51	$ 593

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

3 Securities

a *Analysis of securities*

	2009					
	Term to maturity					
	Within 1 year	*1–5 years*	*5–10 years*	*After 10 years*	*No specific maturity*	*Total fair value*
Available-for-sale securities (at fair value):						
Securities issued or guaranteed by:						
Canada	**$ 3,113**	**$ 8,375**	**$ 294**	**$ –**	**$ –**	**$ 11,782**
Provinces	**52**	**354**	**–**	**–**	**–**	**406**
Foreign governments	**–**	**352**	**–**	**–**	**–**	**352**
	3,165	**9,081**	**294**	**–**	**–**	**12,540**
Others	**–**	**33**	**–**	**–**	**2**	**35**
Investment funds	**–**	**–**	**–**	**–**	**6**	**6**
Equity securities	**26**	**74**	**–**	**–**	**1**	**101**
Total available-for-sale securities	**$ 3,191**	**$ 9,188**	**$ 294**	**$ –**	**$ 9**	**$ 12,682**
Held-for-trading securities (at fair value):						
Securities issued or guaranteed by:						
Canada	**$ 443**	**$ 704**	**$ 138**	**$ 4**	**$ –**	**$ 1,289**
Provinces	**55**	**120**	**13**	**30**	**–**	**218**
	498	**824**	**151**	**34**	**–**	**1,507**
Others	**110**	**60**	**25**	**256**	**–**	**451**
Equity securities	**–**	**–**	**–**	**–**	**28**	**28**
Total held-for-trading securities	**$ 608**	**$ 884**	**$ 176**	**$ 290**	**$ 28**	**$ 1,986**

Notes to Consolidated Financial Statements (continued)

3 Securities *(continued)*

a *Analysis of securities (continued)*

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

Other securities (not included in the above table) not designated as AFS or HFT include merchant banking investments recognized at fair value of $38 million (2008 – $42 million) and investments in equities with significant influence recognized using the equity method of $3 million (2008 – $2 million). At December 31, 2008, other securities included a foreign currency-denominated provincial government bond designated as HTM of $12 million.

The total carrying value of securities includes amounts denominated in currency other than Canadian dollars of $752 million (Canadian equivalent) (2008 – $103 million).

Included in AFS securities issued or guaranteed by Canada are mortgage-backed securities retained by us in connection with mortgage securitizations of $648 million (2008 – $874 million) (note 5).

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

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

Restructuring plan

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

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

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

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

At December 31, 2008, the carrying amount of non-bank ABCP was $212 million, of which $31 million was classified as HFT and $181 million was classified as AFS. Upon implementation of the Plan on January 21, 2009, our existing non-bank ABCP was exchanged for $164 million in Class A-1 notes, $102 million in Class A-2 notes, $18 million in Class B notes and $9 million in Class C notes backed by the pooled assets in MAV2, $31 million in various tracking notes backed by ineligible assets in MAV2, and $4 million in traditional asset tracking notes issued by MAV3. The restructured notes were recorded at fair value on the balance sheet and classified as HFT. The Class A-1, Class A-2, Class B and Class C notes are issued under a senior-subordinated structure in respect of the pooled assets. The Class A-1 notes rank in priority to Class A-2 notes that in turn are senior to the Class B and C notes. The Class A-1 and A-2 notes pay a quarterly coupon of 50 basis points below the Bankers Acceptance rate. The Class B and C subordinated notes are zero coupon in nature, paying interest and principal only after the Class A-1 and A-2 notes are settled in full. The tracking notes pass through the cash flows of the underlying assets. All of the restructured notes are expected to be substantially repaid or mature on or before January, 2017.

During 2009, as a result of proceedings with respect to loan foreclosures and restructurings, the bank acquired restructured notes with a par value of $135 million from borrowers. The notes were initially recognized at their fair value of $81 million, determined by using the bank's valuation model for non-bank ABCP, resulting in credit losses of $40 million being recorded. Following initial recognition and measurement, the notes were classified as HFT and are being accounted for consistently with the bank's other restructured notes.

Fair value

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

The par value of the bank's restructured notes at December 31, 2009, including the repossessed notes described above was $459 million, with a carrying value of $256 million. At December 31, 2008, the carrying amount of non-bank ABCP was $212 million. In the current year, as a result of changes in market conditions, the fair value of the restructured notes decreased by $20 million which was recognized as a reduction in trading revenue. The recorded net carrying value of the restructured notes represents management's best estimate of the fair value of the restructured notes at December 31, 2009.

In prior periods, management's significant assumptions in the valuation of non-bank ABCP included the probability of success of the Plan. In updating the model's assumptions in the current year, management used expected coupon rates, credit ratings and maturity dates of the underlying categories of assets based on the anticipated terms outlined under the Plan and revised assumptions regarding discount rates. Determination of the discount rate is primarily based on interest rates on bankers' acceptances, adjusted by factors including credit spreads on comparable instruments and liquidity premiums. At December 31, 2009, the effect of a 100 basis point adverse change in the discount rate, the valuation model's significant non-observable input, would result in a further decrease in the fair value of the restructured notes of approximately $17 million.

Notes to Consolidated Financial Statements (continued)

3 Securities *(continued)*

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

Fair value (continued)

Our valuation was based on our assessment, at December 31, 2009, of estimates and circumstances that may change in subsequent periods. The assessment of fair values, in management's view, would be transacted between willing buyers and sellers acting on an arm's length basis in an active, liquid market. Although there were a limited number of transactions in the non-bank ABCP notes during 2009, management considers that the absence of an active, liquid market, particularly among the larger holders of the notes, is an indicator that these transactions were not representative of fair market value. Items that may have a material impact on the fair value of the restructured notes include any further changes in economic conditions including market liquidity and interest rates.

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

	2009	2008
Available-for-sale securities		
Realized gains	**$ 30**	$ 1
Realized losses and other-than-temporary impairment	**(23)**	(69)
Gains on other securities	**1**	2
	$ 8	$ (66)

At December 31, 2009, certain of our AFS securities, including preferred shares and mutual fund investments, were identified as being other-than-temporarily impaired. As a result, an impairment charge of $20 million was recognized in non-interest revenue in 2009 (2008 – $8 million).

4 Loans

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

	2009				
	Business and government	*Residential mortgages*	*Consumer finance loans*	*Other consumer loans*	*Total*
Gross amount at end of year	**$ 18,442**	**$ 11,359**	**$ 3,199**	**$ 5,742**	**$ 38,742**
Specific allowance at beginning of year	**161**	**1**	–	–	**162**
Provision for credit losses[1]	**259**	**1**	–	–	**260**
Write-offs, net of recoveries	**(231)**	**(1)**	–	–	**(232)**
Other	**(4)**	–	–	–	**(4)**
Transfers out	–	–	–	–	–
Specific allowance at end of year	**185**	**1**	–	–	**186**
General allowance at beginning of year[2]	**234**	**1**	**194**	**24**	**453**
Provision for credit losses[1]	**(15)**	**1**	**238**	**31**	**255**
Write-offs, net of recoveries	**1**	–	**(231)**	**(26)**	**(256)**
Transfers in	–	–	–	–	–
General allowance at end of year[2]	**220**	**2**	**201**	**29**	**452**
Total allowance[2]	**405**	**3**	**201**	**29**	**638**
Net amount at end of year	**$ 18,037**	**$ 11,356**	**$ 2,998**	**$ 5,713**	**$ 38,104**

4 Loans *(continued)*

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

	2008				
	Business and government	*Residential mortgages*	*Consumer finance loans*	*Other consumer loans*	*Total*
Gross amount at end of year	$ 23,067	$ 11,869	$ 4,029	$ 5,296	$ 44,261
Specific allowance at beginning of year	68	1	–	15	84
Provision for credit losses[1]	130	–	–	–	130
Write-offs, net of recoveries	(37)	–	–	–	(37)
Transfers out	–	–	–	(15)	(15)
Specific allowance at end of year	161	1	–	–	162
General allowance at beginning of year[2]	234	1	161	34	430
Provision for credit losses[1]	–	–	228	21	249
Write-offs, net of recoveries	–	–	(195)	(46)	(241)
Transfers in	–	–	–	15	15
General allowance at end of year[2]	234	1	194	24	453
Total allowance[2]	395	2	194	24	615
Net amount at end of year	$ 22,672	$ 11,867	$ 3,835	$ 5,272	$ 43,646

(1) *Total provision for credit losses for 2009 was $515 million (2008 – $379 million).*

(2) *Includes general allowance for customers who can utilize facilities through either direct borrowings or acceptances.*

Total net loans includes amounts denominated in US dollars of $1,425 million (Canadian equivalent) (2008 – $2,540 million) and other foreign currencies of $43 million (Canadian equivalent) (2008 – $29 million). Included in residential mortgages are $900 million of National Housing Act insured mortgages (2008 – $924 million), and $466 million of mortgages insured by a third party private insurer with an "AA" rating (2008 – $577 million).

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

	Gross impaired amount		*Specific allowance*		*Net of specific allowance*	
	2009	2008	**2009**	2008	**2009**	2008
Business and government	**$ 746**	$ 688	**$ 185**	$ 161	**$ 561**	$ 527
Residential mortgages	**62**	37	**1**	1	**61**	36
Consumer finance loans	**176**	181	**–**	–	**176**	181
Other consumer loans	**38**	26	**–**	–	**38**	26
Total	**$ 1,022**	$ 932	**$ 186**	$ 162	**$ 836**	$ 770

Notes to Consolidated Financial Statements (continued)

5 Loan securitization

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

	Residential mortgages	
	2009	2008
Net securitization activity		
Securitized and sold	**$ 3,551**	$ 4,304
Net cash proceeds received	**3,541**	4,286
Retained rights to future excess interest	**132**	120
Retained servicing liability	**21**	25
Pre-tax gain on sale	**99**	76
Key assumptions at time of sale		
Prepayment rate	**18.00%**	18.98%
Excess spread	**1.67%**	1.27%
Expected credit losses	**0.00%**	0.00%
Discount rate	**3.23%**	4.32%

Servicing and other income from securitized assets was $16 million (2008 – $14 million). No material credit losses were realized on securitized consumer loans in 2009 or 2008.

In connection with securitization, there are $13 million (2008 – $14 million) of segregated deposits included in "Cash and non-interest bearing deposits with the Bank of Canada and other banks" on the consolidated balance sheets held to support the bank's obligations under first loss protection facilities under various securitization programs.

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

	2009	2008
Residential mortgages		
Conventional	**$ 818**	$ 1,417
Mortgage-backed securities(1)	**6,741**	4,827
	7,559	6,244

(1) *Excludes insured mortgages which were securitized and retained by the bank of $648 million (2008 – $874 million). These assets are classified as AFS securities (note 3).*

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

c *Sensitivity of assumptions*

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

	Residential mortgages	
	2009	2008
Fair value of retained interests	**$ 197**	$ 137
Discount rate	**2.99%**	4.02%
Prepayment rate	**18.26%**	18.92%
Expected credit losses	**0.01%**	0.01%

6 Land, buildings and equipment

	2009			2008
	Cost	*Accumulated amortization*	*Net book value*	*Net book value*
Land	**$ 2**	**$ –**	**$ 2**	$ 2
Buildings	**20**	**6**	**14**	14
Furniture and equipment	**67**	**32**	**35**	26
Computer equipment and software	**59**	**45**	**14**	15
Leasehold improvements	**155**	**78**	**77**	69
Total	**$ 303**	**$ 161**	**$ 142**	$ 126

Amortization for 2009 was $35 million (2008 – $32 million).

7 Other assets

	2009	2008
Accrued interest receivable	**$ 154**	$ 177
Interest earning other assets	**222**	175
Due from clients, dealers and clearing corporations	**815**	306
Future income taxes, net (note 26)	**77**	32
Goodwill and other intangible assets, net	**85**	70
Pension asset (note 25)	**93**	78
Accounts receivable and other	**477**	427
Total	**$ 1,923**	$ 1,265

Amortization of intangible assets for 2009 was $11 million (2008 – $14 million). No impairment was recorded in 2009 or 2008.

8 Deposits

	2009			
	Regulated financial institutions	*Individuals*	*Businesses and governments*	*Total*
Demand	**$ 744**	**$ –**	**$ 3,301**	**$ 4,045**
Notice	**–**	**12,363**	**10,105**	**22,468**
Fixed date	**10**	**9,215**	**14,469**	**23,694**
Total	**$ 754**	**$ 21,578**	**$ 27,875**	**$ 50,207**

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

Deposits denominated in US dollars amount to $7,794 million (Canadian equivalent) (2008 – $9,954 million) and in other foreign currencies amount to $2,254 million (Canadian equivalent) (2008 – $1,396 million). Certain deposits have been designated as held-for-trading (note 17).

Notes to Consolidated Financial Statements (continued)

9 Interest bearing liabilities of subsidiaries, other than deposits

	2009	2008
Broker client accounts	**$ 878**	$ 671
Medium-term notes	**2,446**	3,493
	$ 3,324	$ 4,164

Interest expense on medium-term notes was $120 million for 2009 (2008 – $177 million). The weighted average interest rate was 3.72 per cent during 2009 (2008 – 4.14 per cent). Medium-term notes are guaranteed by HSBC Finance Corporation, HSBC Financials' former parent company.

10 Other liabilities

	2009	2008
Accrued interest payable	**$ 340**	$ 387
Mortgages sold with recourse (note 22)	**915**	591
Payable to clients, dealers and clearing corporations	**657**	288
Pension liability (note 25)	**27**	25
Other employee future benefits liability (note 25)	**95**	88
Accounts payable and other	**616**	595
Total	**$ 2,650**	$ 1,974

11 Non-controlling interest in trust and subsidiary

	2009	2008
HSBC Canada Asset Trust	**$ 400**	$ 400
HSBC Mortgage Corporation (Canada)	**30**	30
	$ 430	$ 430

a *HSBC Canada Asset Trust*

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

Unless we fail to declare dividends on our preferred shares, the Trust will make non-cumulative, semi-annual cash distributions to the holders of the HSBC HaTS™. We have covenanted that if the Trust fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 13).

	2009		2008	
	Units	*Amount*	*Units*	*Amount*
HSBC Canada Asset Trust				
HSBC HaTS™ – Series 2010[(1)]	**200,000**	**$ 200**	200,000	$ 200
– Series 2015[(2)]	**200,000**	**200**	200,000	200
		$ 400		$ 400

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

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

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

b *HSBC Mortgage Corporation (Canada)*

The HSBC Group holds $30 million, a 100 per cent interest, of class B perpetual preferred shares issued by HSBC Mortgage Corporation (Canada) ("HMC"), a wholly-owned subsidiary. No dividends were paid or payable on these perpetual preferred shares for the years ended December 31, 2009 and 2008. Dividends may be declared at the discretion of the directors of HMC.

12 Subordinated debentures

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

Interest rate (%)	*Year of maturity*	*Foreign currency amount*	**2009**	2008
Issued to HSBC Group companies				
4.822[(1)]	2094	US$85	**$ 92**	$ 110
Issued to third parties				
4.39[(2)]	2015		**100**	100
4.94[(3)]	2021		**200**	200
4.80[(4)]	2022		**402**	338
30 day bankers' acceptance rate plus 0.50%	2083		**40**	40
			$ 742	$ 678
Total			**$ 834**	$ 788

(1) *The interest rate is fixed at 4.822 per cent until July 2010. These debentures are in a fair value hedging relationship which is adjusted for the fair value of the hedged risk.*

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

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

(4) *Interest rate is fixed at 4.80 per cent until April 10, 2017 and thereafter interest is payable at an annual rate equal to the 90 day bankers' acceptance rate plus 1.00 per cent. These debentures are designated as HFT under the fair value option.*

On November 23, 2009 the bank announced its intention to redeem all $100 million of its 4.39 per cent subordinated debentures due January 21, 2015 (the "Debentures"). In accordance with their terms, the Debentures will be redeemed at 100 per cent of their principal amount plus accrued interest to the redemption date. Subsequent to December 31, 2009, a redemption occurred on January 21, 2010, which was financed out of the general corporate funds of the bank.

Notes to Consolidated Financial Statements (continued)

13 Capital stock

Authorized:

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

Common – 993,677,000 shares.

Issued and fully paid:

	2009		2008	
	Number of shares	*Amount*	*Number of shares*	*Amount*
Preferred Shares Class 1				
Series C[(1)]	**7,000,000**	**$ 175**	7,000,000	$ 175
Series D[(2)]	**7,000,000**	**175**	7,000,000	175
Series E[(3)]	**10,000,000**	**250**	–	–
Preferred shares Class 2				
Series B[(4)]	**86,450,000**	**346**	86,450,000	346
		946		696
Common Shares				
HSBC Bank Canada[(5), (6)]	**498,668,000**	**$ 1,225**	498,668,000	$ 1,225

(1) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.10 per cent, payable quarterly, as and when declared. During 2009 and 2008, $9 million in dividends were declared and paid. The shares are not redeemable by the bank prior to June 30, 2010. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing June 30, 2010, at a declining premium up to June 30, 2014, and at par thereafter. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption.*

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

(2) *The shares are non-voting, non-cumulative and redeemable. Each share yields 5.00 per cent, payable quarterly, as and when declared. During 2009 and 2008, $9 million in dividends were declared and paid.*

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

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

(3) *During 2009, the bank issued 10,000,000 non-voting, non-cumulative and redeemable shares with a par value of $25 each. Each share yields 6.60 per cent, payable quarterly, as and when declared. During 2009, $12 million in dividends were declared and paid.*

The shares are not redeemable by the bank prior to June 30, 2014. Subject to regulatory approval, we may redeem the shares, in whole or in part, for cash commencing June 30, 2014 and on June 30th every five years thereafter at par. In each case, declared and unpaid dividends will also be paid thereon to the date fixed for redemption.

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

(4) *The shares are voting and non-cumulative. During 2008, the bank issued 86,450,000 shares with a fair value of $346 million in consideration for the common shares of HSBC Financial, to HSBC Finance Corporation, a US affiliate (note 2). During 2009, $27 million in dividends were declared and paid. During 2008, $2 million in dividends were declared and paid on January 15, 2009. Each share yields 7.75 per cent, payable quarterly, as and when declared. Holders are entitled to one vote for each share held.*

(5) *During 2009, $280 million (2008 – $270 million) in dividends were declared and paid.*

(6) *During 2008, $50 million in dividends were declared and paid in 2008 on the common shares of HSBC Financial. In 2007, $50 million in dividends were declared and subsequently paid in 2008. HSBC Financial's common shares were cancelled on recapitalization (note 2).*

Dividend restrictions:

We have covenanted that if the Trust fails to pay the indicated yield in full on the HSBC HaTS™, we will not declare dividends on any of our shares unless the Trust first pays the indicated yield (note 11).

14 Variable interest entities

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

	2009		2008	
	Total assets	*Maximum exposure to loss*	*Total assets*	*Maximum exposure to loss*
Unconsolidated VIEs:				
Securitization vehicles managed by the bank[(1)]	**$ 468**	**$ 218**	$ 475	$ 322
Securitization vehicles managed by others[(2)]	**2,280**	**17**	4,676	24
Investment funds[(3)]	**90**	**2**	42	2
Consolidated VIEs:				
Specialized Financing Entity[(4)]	**700**	**–**	700	–

(1) *The maximum exposure to loss resulting from our significant variable interests in these VIEs consists mainly of the bank's ownership interests in the asset-backed commercial paper issued by these VIEs, the fair value of derivatives and the provision of credit enhancement and liquidity facilities. Included in our consolidated balance sheets is $14 million (2008 – $150 million) of asset-backed commercial paper issued by this VIE.*

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

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

(4) *We have issued innovative Tier 1 capital under a capital trust (note 11). This trust is a VIE, but we are considered its primary beneficiary and, therefore, consolidate this structure in our consolidated balance sheets.*

b *Securitization vehicles managed by the bank*

Multi-seller conduit

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

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

For more detail on the liquidity facilities and program-wide credit enhancement facility outlined above, refer to the disclosure on guarantees, commitments and contingent liabilities (note 30).

HSBC Bank plc, a United Kingdom affiliate, provides a first loss subordinated program-wide credit enhancement facility under a Subordinated Program-Wide Committed Purchase Agreement ("SPWE"). The SPWE is sized to cover the majority of the expected losses of the conduit. At December 31, 2009, the authorized limit of the SPWE exceeded the conduit's expected losses; as a result, the bank is not the primary beneficiary and is not required to consolidate the multi-seller conduit under AcG-15.

c *Securitization vehicles managed by others*

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

Notes to Consolidated Financial Statements (continued)

15 Principal subsidiaries

Principal subsidiaries	*Principal office address*	*Shareholders' equity*
HSBC South Point Investments (Barbados), LLP	St. Michael, Barbados	$ 620
HSBC Financial Corporation Limited	Toronto, Ontario	349
HSBC Bridgetown Investments (Barbados), LLC	St. Michael, Barbados	349
HSBC Securities (Canada) Inc.	Toronto, Ontario	232
HSBC Mortgage Corporation (Canada)	Vancouver, British Columbia	124
HSBC Capital (Canada) Inc.	Vancouver, British Columbia	67
HSBC Trust Company (Canada)	Vancouver, British Columbia	52
Household Trust Company	Toronto, Ontario	39
HSBC Loan Corporation (Canada)	Vancouver, British Columbia	11
HSBC Global Asset Management (Canada) Limited	Vancouver, British Columbia	10
HSBC Investment Funds (Canada) Inc.	Vancouver, British Columbia	4

16 Risk management

The risk management policies and procedures of the bank are included in the MD&A. The sections of the Risk Management section, included on pages 25 to 39 of the MD&A where indicated, relating to financial instruments including credit, market and liquidity risks form an integral part of these consolidated financial statements.

17 Classification of financial instruments

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

	2009					
	Held-for-trading	*Available-for-sale*	*Loans and receivables*	*Hedging items*	*Other*[1]	*Total*
Cash resources	**$ 310**	**$ –**	**$ 1,587**	**$ –**	**$ –**	**$ 1,897**
Securities	**1,986**	**12,682**	**–**	**–**	**41**	**14,709**
Securities purchased under reverse repurchase agreements	**–**	**–**	**8,496**	**–**	**–**	**8,496**
Loans[2]	**–**	**–**	**38,104**	**–**	**–**	**38,104**
Customers' liability under acceptances	**–**	**–**	**4,966**	**–**	**–**	**4,966**
Derivatives	**838**	**–**	**–**	**262**	**–**	**1,100**
Land, buildings, equipment and other assets	**–**	**–**	**1,642**	**–**	**423**	**2,065**
Total	**$ 3,134**	**$ 12,682**	**$ 54,795**	**$ 262**	**$ 464**	**$ 71,337**

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

(1) *Included in "Other" are items that do not meet the definition of a financial instrument, financial instruments that have been excluded from the scope of CICA Handbook Section 3855 and HTM securities of $nil (2008 – $12 million).*

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

Notes to Consolidated Financial Statements (continued)

17 Classification of financial instruments *(continued)*

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

	2009					
	Held-for-trading	*Designated as held-for-trading*(1)	*Financial liabilities at amortized cost*	*Hedging items*	*Other*(2)	*Total*
Deposits	**$ –**	**$ 803**	**$ 49,404**	**$ –**	**$ –**	**$ 50,207**
Acceptances	**–**	**–**	**4,966**	**–**	**–**	**4,966**
Interest bearing liabilities of subsidiaries, other than deposits	**–**	**202**	**2,997**	**–**	**125**	**3,324**
Derivatives	**862**	**–**	**–**	**35**	**–**	**897**
Securities sold under repurchase agreements	**–**	**–**	**2,517**	**–**	**–**	**2,517**
Securities sold short	**1,148**	**–**	**–**	**–**	**–**	**1,148**
Equity and other liabilities	**–**	**–**	**2,353**	**–**	**4,661**	**7,014**
Non-controlling interest in trust and subsidiary	**–**	**–**	**–**	**–**	**430**	**430**
Subordinated debentures	**–**	**402**	**340**	**–**	**92**	**834**
Total	**$ 2,010**	**$ 1,407**	**$ 62,577**	**$ 35**	**$ 5,308**	**$ 71,337**

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

(1) *Financial instruments designated as HFT under the fair value option.*

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

17 Classification of financial instruments *(continued)*

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

	2009			
	Contractual amount payable at maturity	*Fair value*	*Cumulative fair value loss*	*Cumulative fair value gain (loss) attributable to credit risk*
Deposits	**$ 784**	**$ 803**	**$ (19)**	**$ (5)**
Interest bearing liabilities of subsidiaries, other than deposits	**200**	**202**	**(2)**	**1**
Subordinated debentures	**400**	**402**	**(2)**	**26**
	$ 1,384	**$ 1,407**	**$ (23)**	**$ 22**

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

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

18 Fair value of financial instruments

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

a *Methods employed in the determination of fair value*

Fair values are determined according to the following hierarchy:

Level 1 – Quoted market price: Financial instruments with quoted prices for identical instruments in active markets.

Level 2 – 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.

Level 3 – Valuation technique with significant non-observable inputs: Financial instruments valued using models where one or more significant inputs are not observable.

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

Notes to Consolidated Financial Statements (continued)

18 Fair value of financial instruments *(continued)*

a *Methods employed in the determination of fair value (continued)*

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

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

b *Analysis of fair value determination*

T-Bills, equities, government bonds, preferred shares and financial liability short positions in government bonds are valued using quoted market prices. Non-bank ABCP, certain mortgage-backed securities, certain retail structured notes and their corresponding offsetting interest rate swaps, certain swaps associated with our securitization programs, and a foreign currency-denominated bond issued with an embedded option and the related swaps are valued using a valuation technique with significant non-observable inputs. All other financial instruments are valued using a valuation technique with observable inputs.

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

The fair value of financial instruments are, in certain circumstances, measured using valuation models that incorporate assumptions that are not supported by prices from observable current market transactions in the same instrument and are not based on observable market data.

A summary of the significant assumptions used in the valuation of non-bank ABCP, and their effect on fair value applying reasonably possible alternatives, is set out in note 3(b).

The valuation of the foreign currency-denominated bond is based on observable inputs and the time value of an embedded option, which is based on normalized volatility of the bank's historical credit spreads.

Swaps associated with our securitization programs are valued using a combination of observable market data and an internal assessment of prepayment rates which are based on historical trends of underlying mortgages. A summary of the significant assumptions relating to the prepayments of mortgages is set out in note 5(c). At December 31, 2009, the effect of a 10 per cent and 20 per cent change in prepayment rates, the valuation model's significant non-observable inputs, would result in an increase or decrease in the fair value of the derivatives of approximately $1 and $2 million respectively.

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

	2009		
	Carrying amount	*Fair value*	*Fair value over (under) carrying amount*
Loans	**$ 38,104**	**$ 38,367**	**$ 263**
Deposits	**49,404**	**49,986**	**582**
Interest bearing liabilities of subsidiaries, other than deposits	**3,122**	**3,069**	**(53)**
Subordinated debentures	**340**	**334**	**(6)**

18 Fair value of financial instruments *(continued)*

d *Analysis of financial instruments not carried at fair value (continued)*

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

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

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

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

– Fair values of securities are based on quoted market prices where available. If quoted market prices are not available, fair values are determined using quoted market prices of similar securities or the use of valuation models.

– For floating rate loans, potential adjustments for credit spread changes are not considered when estimating fair values. Therefore, fair values are assumed to be equal to carrying value.

– Demand and floating rate deposits are assumed to be equal to their carrying value. The fair values of fixed rate deposits are estimated using a discounted cash flow calculation at current rates for deposits with similar terms and risks. Certain deposits are considered either trading liabilities or are designated as HFT using the fair value option.

– The fair value of debentures is determined by reference to current market prices for debt with similar terms and risks. The carrying value of certain deposits is adjusted due to being designated as HFT under the fair value option or is subject to a fair value hedging relationship.

Notes to Consolidated Financial Statements (continued)

18 Fair value of financial instruments *(continued)*

f *Fair value hierarchy*

	As at December 31, 2009			
	Fair Value Measurements Using[1]			
	Level 1	*Level 2*	*Level 3*	*Assets/ liabilities at fair value*
Assets				
Cash resources				
Deposits with regulated financial institutions	$ –	$ 310	$ –	$ 310
	–	310	–	310
Securities				
Available-for-sale securities				
Securities issued or guaranteed by:				
Canada	10,686	1,096	–	11,782
Provinces	406	–	–	406
Foreign governments	–	352	–	352
Others	–	–	35	35
Investment funds	–	6	–	6
Equity securities	101	–	–	101
	11,193	1,454	35	12,682
Held-for-trading securities				
Securities issued or guaranteed by:				
Canada	1,289	–	–	1,289
Provinces	218	–	–	218
Others	76	119	256	451
Equity securities	28	–	–	28
	1,611	119	256	1,986
Others				
Derivatives	–	1,040	60	1,100
	$ 12,804	$ 2,923	$ 351	$ 16,078
Liabilities				
Deposits				
Individuals	–	148	119	267
Business and government	–	–	536	536
	–	148	655	803
Other				
Interest bearing liabilities of subsidiaries, other than deposits	–	202	–	202
Derivatives	–	808	89	897
Securities sold short	1,099	49	–	1,148
	1,099	1,059	89	2,247
Subordinated debentures	–	402	–	402
	$ 1,099	$ 1,609	$ 744	$ 3,452

(1) *There were no significant transfers between Levels 1 and 2.*

18 Fair value of financial instruments *(continued)*

g *Changes in the fair value measurement for instruments categorized as Level 3*

The followings table presents the changes in fair value measurements for instruments included in Level 3 of the fair value hierarchy set out in Section 3862 as described in note 1:

As at December 31, 2009

	Fair value January 1, 2009	*Total realized/ unrealized gains (losses) included in earnings*[(1)]	*Total unrealized gains (losses) included in other compre-hensive income*	*Acquisition of assets/ issuances of liabilities*	*Disposal of assets/ settle-ments of liabilities and others*	*Transfer into Level 3*[(1)]	*Transfer out of Level 3*[(1)]	*Fair value December 31, 2009*	*Changes in unrealized gains (losses) included in earnings for assets and liabilities for positions still held*
Assets									
Securities									
Available-for-sale securities									
Asset-backed securities[(2)]	**$ 181**	**$ –**	**$ –**	**$ –**	**$ (181)**	**$ –**	**$ –**	**$ –**	**$ –**
Mortgage-backed securities	**46**	**(20)**	**11**	**–**	**(2)**	**–**	**–**	**35**	**(20)**
	$ 227	**$ (20)**	**$ 11**	**$ –**	**$ (183)**	**$ –**	**$ –**	**$ 35**	**$ (20)**
Held-for-trading securities									
Asset-backed securities[(2)]	**31**	**(20)**	**–**	**266**	**(21)**	**–**	**–**	**256**	**(20)**
Other									
Derivatives, net of derivative-related liabilities[(3)]	**(223)**	**194**	**–**	**–**	**–**	**–**	**–**	**(29)**	**195**
	$ 35	**$ 154**	**$ 11**	**$ 266**	**$ (204)**	**$ –**	**$ –**	**$ 262**	**$ 155**
Liabilities									
Deposits									
Individual	**(179)**	**7**	**–**	**(27)**	**80**	**–**	**–**	**(119)**	**3**
Businesses and governments	**–**	**4**	**–**	**(540)**	**–**	**–**	**–**	**(536)**	**4**
	$ (179)	**$ 11**	**$ –**	**$ (567)**	**$ 80**	**$ –**	**$ –**	**$ (655)**	**$ 7**

(1) *Transfers in and out of Level 3 are assumed to occur at the end of the period. For an asset or a liability that transfers into Level 3 during the period, the entire change in fair value for the period is excluded from the "Total realized/unrealized gains (losses) included in earnings" column on the reconciliation, whereas for transfers out of Level 3 during the period, the entire change in fair value for the period is included in the said column of the reconciliation.*

(2) *Includes exchange of non-bank ABCP for new MAV notes as described in note 3(b).*

(3) *Net derivatives as at December 31, 2009 included derivative assets of $60 million and derivative liabilities of $89 million. The total amount reported for realized gains included in earnings mostly arises from changes in interest rates, which are observable inputs. See note 18(c) for sensitivity information relating to changes in assumptions for Level 3 inputs. Total realized/unrealized gains (losses) are included in "Other market-to-market accounting gains, net" on the consolidated statements of income.*

Notes to Consolidated Financial Statements (continued)

19 Derivative instruments

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

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

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

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

	2009			
	Notional amount[(1)]	*Fair value*	*Credit equivalent amount*[(2)]	*Risk-weighted balance*[(3)]
Interest rate contracts				
Futures	**$ 1,366**	**$ –**	**$ –**	**$ –**
Swaps	**28,169**	**480**	**633**	**228**
Forward rate agreements	**50**	**–**	**–**	**–**
Caps	**400**	**5**	**8**	**1**
	29,985	**485**	**641**	**229**
Foreign exchange contracts				
Spot contracts	**879**	**1**	**9**	**2**
Forward contracts	**26,307**	**393**	**725**	**113**
Currency futures	**–**	**–**	**–**	**–**
Currency swaps and options	**7,565**	**221**	**525**	**267**
	34,751	**615**	**1,259**	**382**
Other derivative contracts				
Credit	**–**	**–**	**–**	**–**
Equity	**–**	**–**	**–**	**–**
	–	**–**	**–**	**–**
Total	**$ 64,736**	**$ 1,100**	**$ 1,900**	**$ 611**

19 Derivative instruments *(continued)*

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

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

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

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

(3) *Risk-weighted balance represents the amount of regulatory capital required to support the derivative activities. It is estimated by risk weighting the credit equivalent amounts according to the credit worthiness of the counterparties using factors prescribed by OSFI in its capital adequacy guidelines.*

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

Notes to Consolidated Financial Statements (continued)

19 Derivative instruments *(continued)*

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

	2009								
	Trading				*ALM*				
	Under 1 year	*1–5 years*	*Over 5 years*	*Total trading*	*Under 1 year*	*1–5 years*	*Over 5 years*	*Total ALM*	*Total*
Interest rate contracts									
Futures	**$ 940**	**$ 171**	**$ 255**	**$ 1,366**	**$ –**	**$ –**	**$ –**	**$ –**	**$ 1,366**
Swaps	**1,086**	**11,898**	**2,249**	**15,233**	**4,864**	**7,472**	**600**	**12,936**	**28,169**
Forward rate agreements	**–**	**50**	**–**	**50**	**–**	**–**	**–**	**–**	**50**
Caps	**–**	**–**	**400**	**400**	**–**	**–**	**–**	**–**	**400**
	2,026	**12,119**	**2,904**	**17,049**	**4,864**	**7,472**	**600**	**12,936**	**29,985**
Foreign exchange contracts									
Spot contracts	**879**	**–**	**–**	**879**	**–**	**–**	**–**	**–**	**879**
Forward contracts	**24,602**	**1,694**	**11**	**26,307**	**–**	**–**	**–**	**–**	**26,307**
Currency futures	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Currency swaps and options	**2,299**	**2,521**	**755**	**5,575**	**–**	**947**	**1,043**	**1,990**	**7,565**
	27,780	**4,215**	**766**	**32,761**	**–**	**947**	**1,043**	**1,990**	**34,751**
Other derivative contracts									
Credit	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Equity	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
	–	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Total	**$ 29,806**	**$ 16,334**	**$ 3,670**	**$ 49,810**	**$ 4,864**	**$ 8,419**	**$ 1,643**	**$ 14,926**	**$ 64,736**

19 Derivative instruments *(continued)*

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

	2008								
	Trading				*ALM*				
	Under 1 year	*1–5 years*	*Over 5 years*	*Total trading*	*Under 1 year*	*1–5 years*	*Over 5 years*	*Total ALM*	*Total*
Interest rate contracts									
Futures	$ 990	$ –	$ –	$ 990	$ –	$ –	$ –	$ –	$ 990
Swaps	2,911	4,150	2,662	9,723	3,740	12,438	600	16,778	26,501
Caps	20	–	–	20	–	–	–	–	20
	3,921	4,150	2,662	10,733	3,740	12,438	600	16,778	27,511
Foreign exchange contracts									
Spot contracts	376	–	–	376	400	–	–	400	776
Forward contracts	22,173	927	–	23,100	8,506	570	–	9,076	32,176
Currency futures	1	–	–	1	–	–	–	–	1
Currency swaps and options	3,703	2,531	1,446	7,680	9	455	–	464	8,144
	26,253	3,458	1,446	31,157	8,915	1,025	–	9,940	41,097
Other derivative contracts									
Credit	249	–	–	249	–	–	–	–	249
Equity	79	–	–	79	–	–	–	–	79
	328	–	–	328	–	–	–	–	328
Total	$ 30,502	$ 7,608	$ 4,108	$ 42,218	$ 12,655	$ 13,463	$ 600	$ 26,718	$ 68,936

Derivative transactions with HSBC Group companies

Included in the above tables are a number of derivative transactions with HSBC Group companies incurred in the normal course of business at market terms and conditions. At December 31, 2009, the tables included notional amounts of $6,340 million (2008 – $6,334 million) relating to interest rate derivatives, $12,497 million (2008 – $13,154 million) relating to foreign currency derivatives and $nil (2008 – $288 million) relating to other derivatives.

Notes to Consolidated Financial Statements (continued)

19 Derivative instruments *(continued)*

c *The following tables summarize the fair values of the bank's derivative portfolio at December 31 segregated between derivatives that are in a favourable or receivable position and those in an unfavourable or payable position. Fair values of derivative instruments are determined using quoted market prices.*

	2009						
	Trading			*ALM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	**$ 227**	**$ (193)**	**$ 34**	**$ 253**	**$ (25)**	**$ 228**	**$ 262**
Caps	**5**	**(5)**	**–**	**–**	**–**	**–**	**–**
	232	**(198)**	**34**	**253**	**(25)**	**228**	**262**
Foreign exchange contracts							
Spot contracts	**1**	**(6)**	**(5)**	**–**	**–**	**–**	**(5)**
Forward contracts	**393**	**(453)**	**(60)**	**–**	**–**	**–**	**(60)**
Currency swaps and options	**221**	**(214)**	**7**	**–**	**(1)**	**(1)**	**6**
	615	**(673)**	**(58)**	**–**	**(1)**	**(1)**	**(59)**
Other derivative contracts							
Credit	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Total	**$ 847**	**$ (871)**	**$ (24)**	**$ 253**	**$ (26)**	**$ 227**	**$ 203**

	2008						
	Trading			*ALM*			
	Favourable position	*Unfavourable position*	*Net position*	*Favourable position*	*Unfavourable position*	*Net position*	*Total net*
Interest rate contracts							
Swaps	$ 229	$ (242)	$ (13)	$ 576	$ (251)	$ 325	$ 312
Foreign exchange contracts							
Spot contracts	2	(2)	–	–	–	–	–
Forward contracts	857	(834)	23	306	(100)	206	229
Currency swaps and options	452	(446)	6	26	(26)	–	6
	1,311	(1,282)	29	332	(126)	206	235
Other derivative contracts							
Credit	–	(122)	(122)	–	–	–	(122)
Total	$ 1,540	$ (1,646)	$ (106)	$ 908	$ (377)	$ 531	$ 425

20 Interest rate sensitivity

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

	2009									
	Floating rate	*Within 3 months*	*3–12 months*	*Effective interest rate (%)*	*1–5 years*	*Effective interest rate (%)*	*Greater than 5 years*	*Effective interest rate (%)*	*Non-interest sensitive*	*Total*
Cash resources	**$ 310**	**$ 585**	**$ –**	**1.0**	**$ 319**	**3.2**	**$ –**	**–**	**$ 683**	**$ 1,897**
Securities	**1,958**	**2,534**	**2,374**	**0.5**	**7,767**	**2.6**	**–**	**–**	**76**	**14,709**
Securities purchased under reverse repurchase agreements	**–**	**8,496**	**–**	**0.3**	**–**	**–**	**–**	**–**	**–**	**8,496**
Loans	**26,311**	**1,100**	**3,080**	**3.5**	**7,037**	**8.5**	**182**	**5.4**	**394**	**38,104**
Acceptances	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**4,966**	**4,966**
Other assets	**222**	**–**	**–**	**2.0**	**–**	**–**	**–**	**–**	**2,943**	**3,165**
Total assets	**28,801**	**12,715**	**5,454**		**15,123**		**182**		**9,062**	**71,337**
Deposits	**18,623**	**9,506**	**7,357**	**0.9**	**6,295**	**3.3**	**536**	**6.7**	**7,890**	**50,207**
Acceptances	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**4,966**	**4,966**
Interest bearing liabilities of subsidiaries, other than deposits	**878**	**449**	**649**	**1.7**	**1,348**	**4.6**	**–**	**–**	**–**	**3,324**
Securities sold under repurchase agreements	**–**	**1,079**	**1,438**	**0.4**	**–**	**–**	**–**	**–**	**–**	**2,517**
Other liabilities	**1,150**	**–**	**–**	**0.3**	**–**	**–**	**–**	**–**	**3,545**	**4,695**
Non-controlling interest in subsidiaries	**–**	**–**	**200**	**7.8**	**–**	**–**	**200**	**5.1**	**30**	**430**
Subordinated debt	**–**	**140**	**92**	**3.9**	**–**	**–**	**602**	**4.8**	**–**	**834**
Shareholders' equity	**–**	**–**	**–**	**–**	**600**	**5.7**	**346**	**7.8**	**3,418**	**4,364**
Total liabilities and shareholders' equity	**20,651**	**11,174**	**9,736**		**8,243**		**1,684**		**19,849**	**71,337**
On-balance sheet gap	**8,150**	**1,541**	**(4,282)**		**6,880**		**(1,502)**		**(10,787)**	**–**
Off-balance sheet positions	**–**	**(1,707)**	**(903)**		**2,075**		**535**		**–**	**–**
Total interest rate gap	**$ 8,150**	**$ (166)**	**$ (5,185)**		**$ 8,955**		**$ (967)**		**$(10,787)**	**$ –**

Notes to Consolidated Financial Statements (continued)

20 Interest rate sensitivity *(continued)*

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

	2008									
	Floating rate	*Within 3 months*	*3–12 months*	*Effective interest rate (%)*	*1–5 years*	*Effective interest rate (%)*	*Greater than 5 years*	*Effective interest rate (%)*	*Non-interest sensitive*	*Total*
Cash resources	$ 52	$ 1,041	$ –	2.2	$ 273	3.3	$ –	–	$ 489	$ 1,855
Securities	1,029	3,747	2,806	2.0	3,236	3.4	–	–	–	10,818
Securities purchased under reverse repurchase agreements	–	6,682	–	1.5	–	–	–	–	–	6,682
Loans	29,461	1,918	3,150	4.3	8,734	8.0	136	4.4	247	43,646
Acceptances	–	–	–	–	–	–	–	–	5,209	5,209
Other assets	175	–	–	2.4	–	–	–	–	3,664	3,839
Total assets	30,717	13,388	5,956		12,243		136		9,609	72,049
Deposits	14,095	15,458	10,548	2.0	5,554	4.2	–	–	6,307	51,962
Acceptances	–	–	–	–	–	–	–	–	5,209	5,209
Interest bearing liabilities of subsidiaries, other than deposits	669	845	650	2.7	2,000	4.4	–	–	–	4,164
Securities sold under repurchase agreements	–	715	–	1.5	–	–	–	–	–	715
Other liabilities	633	–	–	1.5	–	–	–	–	3,995	4,628
Non-controlling interest in subsidiaries	–	–	–	–	200	7.8	200	5.1	30	430
Subordinated debt	–	40	–	2.0	210	4.4	538	5.4	–	788
Shareholders' equity	–	–	–	–	350	5.1	346	7.8	3,457	4,153
Total liabilities and shareholders' equity	15,397	17,058	11,198		8,314		1,084		18,998	72,049
On-balance sheet gap	15,320	(3,670)	(5,242)		3,929		(948)		(9,389)	–
Off-balance sheet positions	–	(5,455)	1,147		3,708		600		–	–
Total interest rate gap	$ 15,320	$ (9,125)	$ (4,095)		$ 7,637		$ (348)		$ (9,389)	$ –

21 Financial assets pledged and collateral accepted

a *Financial assets pledged to secure liabilities*

		2009		2008
Securities	**$**	**493**	$	226
Loans		**4,000**		3,200
	$	**4,493**	$	3,426

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

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

b *Collateral accepted as security*

The fair value of assets accepted as collateral that we are permitted to sell or repledge in the absence of default is $9,160 million (2008 – $7,334 million). The fair value of any such collateral that has been sold or repledged is $727 million (2008 – $570 million). We are obliged to return equivalent securities.

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

22 Financial assets not qualifying for derecognition

a *Mortgages sold with recourse*

We have agreed to repurchase any mortgage purchased from the bank by the HSBC Mortgage Mutual Fund if any principal and interest payments due are more than 90 days in arrears. Total mortgages sold with recourse at December 31, 2009 were $915 million (2008 – $591 million) and are included in other liabilities.

b *Securities lending*

We have lent securities which we have agreed to repurchase at notice from other banks or customers. The other banks or customers have agreed to return lent securities at our request under terms and conditions that are usual and customary to standard securities lending agreements. The total securities lent at December 31, 2009 were $133 million (2008 – $82 million) and are included in other liabilities.

c *Repurchase agreements*

We have lent securities which we have agreed to repurchase at a specified future date under terms and conditions that are usual and customary to standard repurchase agreements. Total securities at December 31, 2009 which we have agreed to repurchase at a specified future date were $2,517 million (2008 – $715 million) and are separately disclosed in the consolidated balance sheets.

Notes to Consolidated Financial Statements (continued)

23 Net operating income

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

	2009	2008
Income		
Interest earned on financial instruments not held-for-trading	**$ 2,237**	$ 3,326
Fees earned on financial instruments not held-for-trading, other than fees included in effective interest rate calculations on these types of financial instruments	**189**	147
Fees earned on trust and other fiduciary activities where we hold or invest assets on behalf of our customers	**121**	133
Expense		
Interest expense on financial instruments not held-for-trading	**$ 743**	$ 1,642
Fee expense on financial instruments not held-for-trading, other than fees included in effective interest rate calculations on these types of financial instruments	**15**	24
Fee expense relating to trust and other fiduciary activities where we hold or invest assets on behalf of our customers	**9**	11
Gains (losses) recognized		
Securitized loans sold to third parties	**$ 99**	$ 76
Financial instruments held-for-trading	**188**	177
Financial liabilities designated as held-for-trading	**(114)**	100
Hedging items		
Ineffectiveness:		
Cash flow hedges	**(9)**	20
Fair value hedges	**1**	(2)
Economic hedges[1]	**97**	(86)

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

24 Stock-based compensation

Options were previously granted to certain of our employees under the HSBC Holdings Group Share Option Plan ("Group Share Option Plan") until it was terminated in 2005 and the HSBC Savings-Related Share Option Scheme ("Savings-Related Share Option Scheme"). In lieu of options under the Group Share Option Plan, eligible employees now receive grants of ordinary shares of the Parent subject to certain vesting conditions ("Achievement Awards"). Since the shares and contribution commitment under the Group Option Plan have been granted directly by the Parent, the corresponding offset to compensation expense is an increase to contributed surplus, representing a contribution of capital from the Parent. As the shares and awards are in ordinary shares of the Parent traded on the London Stock Exchange, individual share information disclosed below in Canadian dollars has been converted from Pounds Sterling at the date of issue of options or at the date of funding of share purchases.

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

	2009	2008
Savings-Related Share Option Scheme (1, 3 or 5 year vesting period)		
Total options granted	**4,377,137**	1,304,122
Fair value per option granted (in dollars)	**$2.36 – 2.62**	$3.67 – 4.43
Total compensation expense recognized	**$ 7**	$ 4
Significant assumptions used to calculate fair value:		
Risk free interest rate	**0.70 –2.40%**	4.50%
Expected life (years)	**1 – 5**	1 – 5
Expected volatility	**30.00 – 50.00%**	25.00%
Achievement Awards		
Total compensation expense recognized	**$ 22**	$ 28

24 Stock-based compensation *(continued)*

b *Savings-Related Share Option Schemes*

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

c *Achievement Awards*

We provide awards to certain of our employees in the form of performance and non-performance restricted shares of the Parent. Performance related restricted shares generally vest after three years from date of grant, based on certain performance targets. Non-performance related restricted shares are released to the recipients based on continued service, typically at the end of a 31 month vesting period from date of grant. The restricted shares are purchased in the open market and are held in trust on behalf of the employee until vesting. The cost of these shares purchased is recorded as compensation expense over the vesting period.

25 Employee future benefits

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

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

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

	Pension benefits		*Non-pension benefits*	
	2009	2008	**2009**	2008
Accrued benefit obligations				
Balance at beginning of year	**$ 365**	$ 423	**$ 105**	$ 121
Current service cost	**11**	14	**4**	5
Interest cost	**24**	23	**6**	6
Benefits paid	**(20)**	(21)	**(3)**	(3)
Settlements	**(2)**	–	**–**	–
Actuarial loss (gain)	**25**	(75)	**(4)**	(24)
Employee contributions	**1**	1	**–**	–
Balance at end of year	**$ 404**	$ 365	**$ 108**	$ 105
Plan assets				
Fair value at beginning of year	**$ 314**	$ 378	**$ –**	$ –
Actual return on plan assets	**19**	(57)	**–**	–
Bank contributions	**29**	12	**3**	3
Employee contributions	**1**	1	**–**	–
Benefits paid	**(20)**	(20)	**(3)**	(3)
Settlements	**(2)**	–	**–**	–
Fair value at end of year	**$ 341**	$ 314	**$ –**	$ –
Funded status				
Funded status – deficit	**$ (63)**	$ (51)	**$ (108)**	$ (105)
Bank contributions after measurement date	**2**	1	**–**	–
Unamortized net actuarial loss	**142**	124	**27**	31
Unamortized past service costs	**9**	9	**(16)**	(18)
Unamortized transitional (asset) obligation	**(22)**	(26)	**2**	4
Accrued benefit asset (liability)	**68**	57	**(95)**	(88)
Valuation allowance	**(2)**	(4)	**–**	–
Accrued benefit asset (liability), net of valuation allowance	**$ 66**	$ 53	**$ (95)**	$ (88)

Notes to Consolidated Financial Statements (continued)

25 Employee future benefits *(continued)*

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

	Pension benefits		*Non-pension benefits*	
	2009	2008	**2009**	2008
Other assets (note 7)	**$ 93**	$ 78	**$ –**	$ –
Other liabilities (note 10)	**(27)**	(25)	**(95)**	(88)
Total	**$ 66**	$ 53	**$ (95)**	$ (88)

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

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

	2009	2008
Accrued benefit obligations	**$ 304**	$ 261
Fair value of plan assets	**230**	191
Funded status – deficit at measurement date	**74**	70
Bank contributions after measurement date	**2**	1
Funded status – deficit at end of year	**$ 72**	$ 69

The distribution of the pension plan assets is shown below:

	Percentage of pension plan assets (%)	
	2009	2008
Equity securities	**67**	63
Debt securities	**32**	36
Other	**1**	1
Total	**100**	100

The expense for employee future benefits is as follows:

	Pension benefits		*Non-pension benefits*	
	2009	2008	**2009**	2008
Service cost	**$ 11**	$ 14	**$ 4**	$ 5
Interest cost	**24**	23	**6**	6
Actual return on plan assets	**(19)**	57	**–**	–
Actuarial loss (gain) on accrued benefit obligation	**25**	(75)	**(4)**	(24)
Settlement loss	**1**	–	**–**	–
Costs arising in the year	**42**	19	**6**	(13)
Differences between costs arising in the year and costs recognized in the year in respect of:				
– Actual and expected return on plan assets	**(3)**	(84)	**–**	–
– Actuarial (gain) loss	**(18)**	80	**5**	26
– Amendments	**1**	1	**(2)**	(2)
– Amortization of transitional (asset) obligation	**(3)**	(3)	**1**	1
Net benefit plan expense recognized before change in valuation allowance	**19**	13	**10**	12
Decrease in valuation allowance	**(2)**	(11)	**–**	–
Net benefit plan expense	**17**	2	**10**	12
Defined contribution plan expense	**19**	17	**–**	–
Total expense	**$ 36**	$ 19	**$ 10**	$ 12

The total cash payments for employee future benefits for 2009, consisting of cash contributed by the bank to our funded pension plans, cash paid directly to beneficiaries for our unfunded pension arrangements and payments to third party service providers in respect of our post-retirement, non-pension arrangements were $56 million (2008 – $32 million).

Actuarial valuations for the bank's pension plans are prepared at least every three years. The most recent actuarial valuations of the defined benefit pension plans for funding purposes were conducted as at December 31, 2006 with the exception of one plan that was valued as at December 31, 2008. The next actuarial valuations for funding purposes of these plans are required as at December 31, 2009. The post-retirement, non-pension actuarial valuation was conducted as at July 1, 2009.

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

	Pension benefits		*Non-pension benefits*	
	2009	2008	**2009**	2008
Accrued benefit obligations				
Discount rate (%)	**6.25**	6.50 – 7.00	**6.25**	6.50 – 7.00
Rate of compensation increase (%)	**3.50 – 3.80**	3.80 – 4.00	**n/a**	3.80 – 4.00
Net benefit plan expense				
Discount rate (%)	**6.50 – 7.00**	5.25 – 5.50	**6.25 – 6.50**	5.25 – 5.50
Expected long-term rate of return on plan assets (%)	**6.75 – 7.00**	7.00 – 7.50	**n/a**	n/a
Rate of compensation increase (%)	**3.80 – 4.00**	3.80 – 4.00	**0.00 – 3.50**	3.80 – 4.00

In 2009, for measurement purposes, a 7.30 – 9.00 per cent health care cost trend rate was assumed grading down to 4.90 – 5.00 per cent in 2015 and thereafter (2008 – 8.20 – 9.00 per cent grading down to 4.90 – 5.00 per cent in 2012 and thereafter).

The expected average remaining service lives of the active employees under the pension plans is 15 years and 19 years under the post-retirement, non-pension arrangements.

Sensitivity of Assumptions

The following table shows the sensitivity of the accrued benefit obligations at the end of 2009, as well as the net benefits expense for 2009, to changes in the significant actuarial assumptions. The sensitivities in each key variable have been calculated independently of changes in other key variables.

	Pension benefits		*Non-pension benefits*	
	Accrued benefit obligation	*Benefits expense*	*Accrued benefit obligation*	*Benefits expense*
Expected rate of return on plan assets (%)	–	6.50 – 7.00	–	–
Impact of 1% increase	$ –	$ (3)	$ –	$ –
Impact of 1% decrease	$ –	$ 3	$ –	$ –
Discount rate (%)	6.25	6.25 – 6.50	6.25	6.25 – 6.50
Impact of 1% increase	$ (59)	$ (4)	$ (16)	$ (1)
Impact of 1% decrease	$ 73	$ 5	$ 21	$ 1
Rate of compensation increase (%)	3.50 – 3.80	3.50 – 3.80	–	–
Impact of 0.25% increase	$ 7	$ –	$ –	$ –
Impact of 0.25% decrease	$ (7)	$ –	$ –	$ –
Assumed overall health care cost trend (%)	–	–	7.30 – 8.50	8.20 – 8.50[1]
Impact of 1% increase	$ –	$ –	$ 9	$ 1
Impact of 1% decrease	$ –	$ –	$ (8)	$ (1)

(1) *For measurement purposes, a 7.30 – 9.00 per cent health care cost trend rate in 2009 was assumed grading down to 4.90 – 5.00 per cent in 2015 and thereafter.*

Notes to Consolidated Financial Statements (continued)

26 Income taxes

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

	2009	2008
Current income taxes:		
Federal	**$ 133**	$ 118
Provincial	**85**	81
Foreign	**45**	–
	263	199
Future income taxes:		
Federal	**(34)**	33
Provincial	**(22)**	21
	(56)	54
Total provision for income taxes	**$ 207**	$ 253

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

	2009 (%)	2008 (%)
Combined federal and provincial income tax rate	**31.1**	32.7
Adjustments resulting from:		
Adjustment for tax exempt income	**(0.3)**	(0.3)
Substantively enacted tax rate changes	**(0.1)**	0.1
Additional financial institution taxes	**0.1**	–
Other, net	**(1.7)**	(2.6)
Effective tax rate	**29.1**	29.9

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

	2009	2008
Future income tax assets:		
Allowance for credit losses	**$ 82**	$ 87
Other available deductions	**106**	64
Other	**12**	27
	200	178
Future income tax liabilities:		
Leases	**63**	69
Deferred charges	**12**	45
Securitization-related	**43**	29
Building and equipment	**5**	3
	123	146
Net future income tax asset	**$ 77**	$ 32

27 Capital management

a *Objectives, policies and processes*

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

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

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

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

b *Capital managed and capital ratio regulations*

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

OSFI considers financial institutions to be well-capitalized if they maintain a Tier 1 capital ratio (as a percentage of risk-weighted assets) of 7 per cent and a total regulatory capital ratio of 10 per cent. The bank maintained ratios that exceeded these requirements in both 2009 and 2008.

In addition to regulatory capital ratios, banks are expected to meet an assets-to-capital multiple test. The assets-to-capital multiple is calculated by dividing a bank's total assets, including specified off-balance sheet items, by its total capital. The bank met the assets-to-capital multiple test in both 2009 and 2008.

c *Revision of regulatory capital management framework*

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

Notes to Consolidated Financial Statements (continued)

27 Capital management *(continued)*

d *Regulatory capital*

	2009	2008
Tier 1 capital		
Common shares	**$ 1,225**	$ 1,225
Contributed surplus	**7**	–
Retained earnings	**2,113**	1,950
Non-cumulative preferred shares	**946**	696
Non-controlling interests in trust and subsidiary[1]	**430**	430
Securitization-related deductions and other	**(139)**	(89)
Goodwill	**(15)**	(15)
Total Tier 1 capital	**$ 4,567**	$ 4,197
Tier 2 capital		
Subordinated debentures	**$ 834**	$ 788
Other	**230**	245
Securitization-related deductions	**(23)**	(29)
Total Tier 2 capital	**$ 1,041**	$ 1,004
Total capital available for regulatory purposes	**$ 5,608**	$ 5,201

(1) *Includes $400 million of HSBC HaTS™ (2008 – $400 million).*

28 Segmented information

a *Customer groups*

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

A description of each customer group is as follows:

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

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

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

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

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

In 2008, the bank acquired HSBC Financial from HSBC Financial Corporation (note 2). The results of operations of HSBC Financial have been reported as the Consumer Finance customer group.

28 Segmented information *(continued)*

a *Customer groups (continued)*

	2009				
	Personal Financial Services	*Commercial Banking*	*Global Banking and Markets*	*Consumer Finance*	*Total*
Net interest income	**$ 357**	**$ 692**	**$ 53**	**$ 377**	**$ 1,479**
Non-interest revenue	**291**	**245**	**396**	**19**	**951**
Total revenue	**648**	**937**	**449**	**396**	**2,430**
Non-interest expenses	**550**	**304**	**136**	**187**	**1,177**
Net operating income	**98**	**633**	**313**	**209**	**1,253**
Provision for credit losses	**42**	**223**	**12**	**238**	**515**
Income (loss) before undernoted	**56**	**410**	**301**	**(29)**	**738**
Provision for (recovery of) income taxes	**16**	**101**	**100**	**(10)**	**207**
Non-controlling interest in income of trust	**5**	**16**	**5**	**–**	**26**
Net income (loss)	**$ 35**	**$ 293**	**$ 196**	**$ (19)**	**$ 505**
Preferred share dividends	**7**	**18**	**5**	**27**	**57**
Net income (loss) attributable to common shares	**$ 28**	**$ 275**	**$ 191**	**$ (46)**	**$ 448**
Average assets	**$ 18,290**	**$ 24,249**	**$ 25,626**	**$ 3,530**	**$ 71,695**

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

Notes to Consolidated Financial Statements (continued)

28 Segmented information *(continued)*

b *Geographic*

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

	2009			
	Assets		*Liabilities*	
	Amount	*Per cent*	*Amount*	*Per cent*
Canada	**$ 69,220**	**97.0**	**$ 62,865**	**93.9**
United States	**1,281**	**1.8**	**545**	**0.8**
Other countries	**836**	**1.2**	**3,563**	**5.3**
Total	**$ 71,337**	**100.0**	**$ 66,973**	**100.0**

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

29 Related party transactions

Fees are charged by HSBC Group companies with respect to guarantees of deposits and medium-term notes, and administrative and technical services provided to us. The total fees for the year amounted to $118 million (2008 – $109 million) and were recorded in non-interest expenses.

Fees are received from HSBC Group companies with respect to administrative and technical services provided by us. The total fees received for the year amounted to $16 million (2008 – $6 million) and were recorded in non-interest revenue.

Included in non-interest revenue were fees of $20 million (2008 – $23 million) received from an HSBC Group company arising from the sale of credit life, accident, disability, health and unemployment insurance policies relating to customer borrowings.

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

A certain company within the HSBC Group has agreed to provide a standby borrowing facility of up to US $500 million to the bank at market rates and conditions. Funds have not been drawn from the facility since entering into the agreement.

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

30 Guarantees, commitments and contingent liabilities

a *Credit-related*

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

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

a *Credit-related (continued)*

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

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

	2009	2008
Financial and performance standby letters of credit	**$ 2,249**	$ 2,570
Documentary and commercial letters of credit	**228**	397
Commitments to extend credit	**36,229**	37,426
Credit and yield enhancement	**13**	14
	$ 38,719	$ 40,407

b *Long-term lease commitments*

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

2010	$ 56
2011	50
2012	41
2013	42
2014	36
2015 (and thereafter)	125
	$ 350

The total rental expense charged in respect of premises for 2009 was $66 million (2008 – $63 million).

c *Litigation and legal proceedings*

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

d *Contingent liabilities*

During 2004, the Canada Revenue Agency issued Notices of Reassessments with respect to a specific material issue relating to the 1996-2001 taxation years. We have filed Notices of Objections. The ultimate resolution of these issues is indeterminate at this stage. However, we believe that adequate provisions to cover these matters are reflected in the consolidated balance sheets at December 31, 2009 and 2008.

e *Backstop liquidity facilities*

Backstop liquidity facilities are provided to asset-backed commercial paper conduit programs ("programs") administered by the bank and third parties, as an alternative source of financing in the event that such programs are unable to access commercial paper markets, or in limited circumstances, when predetermined performance measures of the financial assets owned by these programs are not met. Generally, these facilities have a term of up to one year. The terms of the backstop liquidity facilities do not require us to advance money to these programs in the event of bankruptcy or to purchase non-performing or defaulted assets. None of the backstop liquidity facilities provided to programs administered by the bank have been drawn upon. No amounts were drawn on backstop liquidity facilities provided to programs administered by third parties at December 31, 2009 or 2008. Undrawn commitments in respect of backstop liquidity facilities are included in the amounts in note 30(a) above.

Notes to Consolidated Financial Statements (continued)

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

f *Credit enhancements*

The bank provides partial program-wide credit enhancement to the multi-seller conduit program administered by it to protect commercial paper investors in the event that the collections on the underlying assets and any draws on the transaction specific credit enhancement and liquidity backstop facilities are insufficient to repay the maturing asset-backed commercial paper issued by such multi-seller conduit program. Each of the asset pools funded by this multi-seller conduit program is structured to achieve a high investment grade credit profile through the provision of transaction specific credit enhancement provided by the seller of each asset pool to this multi-seller conduit program. The term of this program-wide credit enhancement is 12 months.

HSBC Group International Network*

Services are provided by around 8,000 offices in 87 countries and territories:

Europe	Offices
Armenia	7
Austria	1
Belgium	2
Channel Islands	39
Cyprus	1
Czech Republic	4
France	423
Georgia	2
Germany	14
Greece	20
Hungary	1
Ireland	7
Isle of Man	5
Italy	3
Luxembourg	4
Malta	49
Monaco	2
Netherlands	1
Poland	16
Russia	8
Slovakia	2
Spain	4
Sweden	2
Switzerland	16
Turkey	339
Ukraine	1
United Kingdom	1,555

Asia-Pacific	Offices
Australia	34
Bangladesh	11
Brunei Darussalam	12
China	170
Cook Islands	1
Hong Kong Special Administrative Region	330
India	150
Indonesia	211
Japan	14
Kazakhstan	4
Korea, Republic of	15
Macau Special Administrative Region	7
Malaysia	51
Maldives	1
New Zealand	11
Pakistan	12
Philippines	27
Singapore	27
Sri Lanka	16
Taiwan	44
Thailand	1
Vietnam	12

Americas	Offices
Argentina	181
Bahamas	6
Bermuda	14
Brazil	1,518
British Virgin Islands	3
Canada	268
Cayman Islands	13
Chile	3
Colombia	28
Costa Rica	39
El Salvador	82
Honduras	79
Mexico	1,206
Nicaragua	1
Panama	78
Paraguay	6
Peru	22
United States of America	528
Uruguay	12
Venezuela	1

Middle East and Africa	Offices
Algeria	2
Bahrain	9
Egypt	79
Iran	1
Iraq	17
Israel	3
Jordan	5
Kuwait	1
Lebanon	8
Libya	2
Mauritius	12
Nigeria	1
Oman	9
Palestinian Autonomous Area	1
Qatar	6
Saudi Arabia	94
South Africa	5
United Arab Emirates	30

Associated companies are included in the network of offices.

HSBC Bank Canada Bank Branches and Subsidiaries**

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

Alberta:
Calgary (10)
Edmonton (6)
Lethbridge
Medicine Hat
Red Deer
St. Albert

Saskatchewan:
Regina
Saskatoon

Manitoba:
Winnipeg (2)

Ontario:
Aurora
Barrie
Brampton (2)
Burlington
Etobicoke
Hamilton
Kanata
Kingston
Kitchener
London
Markham (5)
Milton
Mississauga (4)
Oakville
Oshawa
Ottawa
Richmond Hill (2)
St. Catharines
Sault Ste. Marie
Scarborough (3)
Thunder Bay
Timmins
Toronto (12)
Unionville
Vaughan (3)
Willowdale
Windsor
Woodbridge

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

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* *At March 1, 2010*
** *At December 31, 2009*

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** At March 1, 2010*

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