

GRUPO FINANCIERO HSBC, S. A. DE C. V.
Sociedad Controladora Filial
AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2005 and 2004

(With Independent Auditors' Report Thereon)

(Free Translation from Spanish Language Original)



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Independent Auditors' Report
(Free translation from Spanish language original)

The Board of Directors and Stockholders
Grupo Financiero HSBC, S. A. de C. V.,
Sociedad Controladora Filial:

(Thousands of Mexican pesos of constant purchasing power
as of December 31, 2005, except when indicated otherwise)

We have examined the accompanying consolidated balance sheets of Grupo Financiero HSBC, S. A. de C. V., Sociedad Controladora Filial and subsidiaries ("the Group") as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and changes in financial position for the years then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Mexico. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and are prepared in accordance with the accounting criteria for financial group holding companies in Mexico. An audit consists of examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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. We believe that our audits provide a reasonable basis for our opinion.

As explained in note 2 to the consolidated financial statements, the Group is required to prepare and present its consolidated financial statements in accordance with the accounting criteria established by the National Banking and Securities Commission ("the Banking Commission") for financial group holding companies in Mexico, which in general conform to accounting principles generally accepted in Mexico, issued by the Mexican Institute of Public Accountants. These accounting criteria include particular rules that in certain respects depart from these principles.

Acquisition of Grupo Financiero Finacomer, S. A. and Subsidiaries and HSBC Bank Panamá, S. A.-

As explained in note 13 to the financial statements, on September 1, 2005 HSBC Bank (Panamá), S. A. acquired all the operations of Grupo Finacomer, S. A. and affiliated companies, which entailed acquiring assets, liabilities and stockholders' equity amounting to USD 40, USD 28 and USD 12 million, respectively. On July 31, 2004 the Group acquired from HSBC Bank USA 100% of the shares representing the capital stock of 15 branches, along with their respective assets and liabilities, that include 100% of the capital stock of Overseas Realty Corporation of Panamá, Panamá Realty Investment, S. A., HSBC Investment Corporation (Panamá), S. A. and HSBC Securities (Panamá), S. A., with assets, liabilities and stockholders' equity of USD 1,019, USD 895 and USD 124 million, respectively. For legal and statutory reasons, a new bank has been created from these companies, called HSBC Bank (Panamá), S. A.

(Continued)



In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Grupo Financiero HSBC, S. A. de C. V., Sociedad Controladora Filial and subsidiaries as of December 31, 2005 and 2004, and the results of their operations, the changes in their stockholders' equity and the changes in their financial position for the years then ended, in conformity with the accounting criteria established by the Banking Commission for financial group holding companies in Mexico, as described in note 2 to the consolidated financial statements.

KPMG CARDENAS DOSAL, S. C

Carlos Rivera Nava

February 20, 2006.



GRUPO FINANCIERO HSBC, S. A. DE C. V.
Sociedad Controladora Filial
AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2005 and 2004

(Thousands of Mexican pesos of constant purchasing power as of December 31, 2005)

Assets	2005	2004	Liabilities and Stockholders' Equity	2005	2004
Cash and equivalents (note 5)	\$ 55,291,297	47,089,168	Deposit funding (note 14):		
Investment securities (note 6):			Demand deposits	\$ 125,512,978	115,400,412
Trading	6,944,984	3,064,255	Time deposits:		
Available-for-sale	46,021,613	40,333,640	General public	83,454,441	68,887,856
Held-to-maturity	3,993,255	4,147,506	Money market	3,348,667	838,260
	<u>56,959,852</u>	<u>47,545,401</u>	Bonds	<u>-</u>	<u>55,414</u>
				<u>212,316,086</u>	<u>185,181,942</u>
Securities and derivative transactions:			Due to banks and other institutions (notes 9c and 15):		
Debit balances of repurchase/resell agreements (note 7)	186,073	68,894	Short-term	4,836,435	6,618,654
Derivative financial instruments (note 8)	381,924	43,291	Long-term	2,126,396	2,625,167
	<u>567,997</u>	<u>112,185</u>		<u>6,962,831</u>	<u>9,243,821</u>
Current loan portfolio (note 9):			Securities and derivative transactions:		
Commercial loans	45,750,970	31,329,980	Credit balances of repurchase/resell agreements (note 7)	113,029	41,394
Financial institutions	6,895,721	4,269,445	Securities lending (note 16)	4,388,764	-
Consumer loans	25,660,384	16,480,249	Derivative financial instruments (note 8)	<u>-</u>	<u>58</u>
Residential mortgages	20,099,326	16,640,090		4,501,793	41,452
Government entities	36,162,457	6,478,415			
IPAB	1,096,145	43,019,797	Other accounts payable:		
Total current loan portfolio	<u>135,665,003</u>	<u>118,217,976</u>	Income tax and employee statutory profit sharing	1,297,876	742,185
Past due loan portfolio (note 9):			Sundry creditors and other accounts payable	<u>21,660,690</u>	<u>9,065,139</u>
Commercial loans	1,667,215	1,993,553		<u>22,958,566</u>	<u>9,807,324</u>
Financial institutions	302	311	Subordinated debentures outstanding (note 18)	2,579,060	2,674,929
Consumer loans	817,408	548,313	Deferred credits	20,030	86,292
Residential mortgages	1,021,337	918,612		<u>249,338,366</u>	<u>207,035,760</u>
Other past due debts	27,775	42,180	Total liabilities		
Total past due loan portfolio	<u>3,534,037</u>	<u>3,502,969</u>	Stockholders' equity (note 20):		
Total loan portfolio	139,199,040	121,720,945	Paid-in capital :		
Less:			Capital stock	7,592,871	7,592,871
Allowance for loan losses (note 9d)	5,897,172	6,758,066	Additional paid-in capital	<u>12,260,234</u>	<u>12,260,234</u>
Loan portfolio, net	<u>133,301,868</u>	<u>114,962,879</u>	Earned capital:		
Other accounts receivable, net	15,218,176	4,498,656	Statutory reserves	634,136	465,607
Foreclosed assets (note 10)	393,521	561,471	Results of prior years	7,639,470	4,437,413
Premises, furniture and equipment, net (note 11)	5,475,454	4,350,368	Cumulative translation adjustment	(7,019)	(911)
Permanent investments in shares (note 12)	2,244,956	2,306,512	Deficit in restatement of stockholder's equity	(3,689,149)	(3,690,884)
Deferred income tax (note 19)	746,802	2,274,609	Results from holding nonmonetary assets:		
Other assets (note 13):			From valuation of permanent investments in shares	(3,630,543)	(3,697,410)
Goodwill	3,238,681	3,147,784	Net income	<u>4,980,924</u>	<u>3,370,586</u>
Deferred charges and intangibles	1,682,986	927,263		5,927,819	884,401
			Minority interest	<u>2,300</u>	<u>3,030</u>
			Total stockholders' equity	<u>25,783,224</u>	<u>20,740,536</u>
			Commitments and contingent liabilities (note 24)		
Total assets	\$ <u>275,121,590</u>	<u>227,776,296</u>	Total liabilities and stockholders' equity	\$ <u>275,121,590</u>	<u>227,776,296</u>

(Continued)

GRUPO FINANCIERO HSBC, S. A. DE C. V.
Sociedad Controladora Filial
AND SUBSIDIARIES

Consolidated Balance Sheets, Continued

December 31, 2005 and 2004

(Thousands of Mexican pesos of constant purchasing power as of December 31, 2005)

Memorandum accounts

<u>Transactions on behalf of third parties</u>	<u>2005</u>	<u>2004</u>	<u>Transactions for the Group's own accounts</u>	<u>2005</u>	<u>2004</u>
Customer current accounts:			Memorandum accounts:		
Customer banks	\$ 394	789	Guarantees issued (note 22)	\$ 56,717	224,156
Settlement of customer transactions	<u>788</u>	<u>(5,189)</u>	Irrevocable lines of credit (note 22)	3,761,174	2,256,557
	<u>1,182</u>	<u>(4,400)</u>	Assets in trust or under mandate (note 22)	67,768,668	63,605,458
Customer securities:			Assets in custody or under management (note 22)	56,937,245	50,566,519
Customer securities in custody	65,591,770	49,433,076	Amounts committed under agreements with the IPAB	123,227	982,613
Pledged customer securities and documents	<u>1,145,700</u>	<u>575,711</u>	Amounts contracted in derivative instruments	205,915,174	94,647,506
	<u>66,737,470</u>	<u>50,008,787</u>	Securities in custody	3,986,024	4,082,572
			Other contingent obligations	<u>482,458,177</u>	<u>9,654,208</u>
Transactions on behalf of customers (note 22):				<u>821,006,406</u>	<u>226,019,589</u>
Customers repurchase transactions	2,410,638	2,618,817	Repurchase/resell agreements (note 7)		
Investments on behalf of customers, net	<u>16,865,536</u>	<u>25,624,189</u>	Securities receivable under repurchase agreements	44,434,490	39,776,523
	<u>19,276,174</u>	<u>28,243,006</u>	Less - Creditors under agreements to repurchase	<u>44,449,920</u>	<u>39,749,216</u>
Total on behalf of third parties	86,014,826	78,247,393		<u>(15,430)</u>	<u>27,307</u>
Investment of the SAR funds	3,291,645	2,957,550	Debtors under agreements to resell	15,943,878	8,836,096
Credit rating risk of loan portfolio	131,293,665	115,147,699	Less - Securities deliverable under resell agreements	<u>15,855,404</u>	<u>8,835,903</u>
Other memorandum accounts	<u>346,896,766</u>	<u>322,348,042</u>		<u>88,474</u>	<u>193</u>
Total on behalf of third parties	\$ <u>481,482,076</u>	<u>440,453,291</u>	Net repurchase/resell agreements	<u>73,044</u>	<u>27,500</u>
			Total own accounts	\$ <u>821,079,451</u>	<u>226,047,089</u>

See accompanying notes to the consolidated financial statements.

"These consolidated balance sheets, with those of the financial and other entities comprising the Financial Group that are subject to consolidation, were prepared in accordance with the accounting criteria for financial group holding companies issued by the National Banking and Securities Commission based on Article 30 of the Law that Regulates Financial Groups, which are of a general and mandatory nature and have been applied on a consistent basis. Accordingly, they reflect the transactions carried out by the Holding Company and the financial and other entities comprising the Financial Group that are subject to consolidation, through the dates noted above. Furthermore, these transactions were carried out and valued in accordance with sound banking practices and the applicable legal and administrative provisions."

These consolidated balance sheets were approved by the Board of Directors under the responsibility of the undersigned officers.

The historical capital stock of the Financial Group amounts to \$3,886,064,278 nominal pesos.

Signature _____
Alexander A. Flockhart
President and Chief Executive Officer

Signature _____
Germán Osuna Castelán
Chief Financial Officer

Signature _____
W. Graham Thomson
Director of Internal Audit

Signature _____
Sergio Armando Torres López
Chief Accountant

GRUPO FINANCIERO HSBC, S. A. DE C. V.
Sociedad Controladora Filial
AND SUBSIDIARIES

Consolidated Statements of Operations

Years ended December 31, 2005 and 2004

(Thousands of Mexican pesos of constant purchasing power as of December 31, 2005)

	<u>2005</u>	<u>2004</u>
Interest income (note 23)	\$ 26,350,072	19,393,578
Interest expense (note 23)	(10,836,486)	(7,197,902)
Monetary position result, net	<u>(320,331)</u>	<u>(350,544)</u>
Financial margin	15,193,255	11,845,132
Allowance for loan losses (note 9d)	<u>(1,499,394)</u>	<u>(1,369,791)</u>
Financial margin net of allowance for loan losses	13,693,861	10,475,341
Commission and fee income	8,435,540	7,616,712
Commission and fee expense	(917,301)	(637,399)
Financial intermediation income (note 23)	<u>1,363,434</u>	<u>912,881</u>
Total operating income	22,575,534	18,367,535
Administrative and promotional expenses	<u>(15,830,083)</u>	<u>(12,987,572)</u>
Net operating income	6,745,451	5,379,963
Other income (note 23)	1,494,595	1,363,046
Other expense (note 23)	<u>(1,020,921)</u>	<u>(1,076,352)</u>
Income before income tax, employee statutory profit sharing (ESPS) and equity in the results of unconsolidated subsidiaries, associated and affiliated companies	<u>7,219,125</u>	<u>5,666,657</u>
Current income tax (IT) (note 19)	(1,491,088)	(1,247,751)
Deferred IT and ESPS (note 19)	<u>(1,346,079)</u>	<u>(1,269,443)</u>
Income before equity in the results of unconsolidated subsidiaries, associated and affiliated companies	<u>(2,837,167)</u>	<u>(2,517,194)</u>
Income before equity in the results of unconsolidated subsidiaries, associated and affiliated companies	4,381,958	3,149,463
Equity in the results of unconsolidated subsidiaries, associated and affiliated companies, net	<u>675,389</u>	<u>228,482</u>
Income from continuing operations	5,057,347	3,377,945
Discontinued operations, extraordinary items and changes in accounting policies net (note 23)	<u>(76,037)</u>	<u>(7,072)</u>
Net income before minority interest	4,981,310	3,370,873
Minority interest	<u>(386)</u>	<u>(287)</u>
Net income	<u>\$ 4,980,924</u>	<u>3,370,586</u>

See accompanying notes to the consolidated financial statements.

"These consolidated statements of operations, with those of the financial and other entities comprising the Financial Group that are subject to consolidation, were prepared in accordance with the accounting criteria for financial group holding companies issued by the National Banking and Securities Commission based on Article 30 of the Law that Regulates Financial Groups, which are of a general and mandatory nature and have been applied on a consistent basis. Accordingly, they reflect the revenues and disbursements relating to the transactions carried out by the Holding Company and the financial and other entities comprising the Financial Group that are subject to consolidation, for the years noted above. Furthermore, these transactions were carried out and valued in accordance with sound banking practices and the applicable legal and administrative provisions.

These consolidated statements of operations were approved by the Board of Directors under the responsibility of the undersigned officers."

Signature _____
Alexander A. Flockhart
President and Chief Executive Officer

Signature _____
Germán Osuna Castela
Chief Financial Officer

Signature _____
W. Graham Thomson
Director of Internal Audit

Signature _____
Sergio Armando Torres López
Chief Accountant

GRUPO FINANCIERO HSBC, S. A. DE C. V.
Sociedad Controladora Filial
AND SUBSIDIARIES

Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2005 and 2004

(Thousands of Mexican pesos of constant purchasing power as of December 31, 2005)

	<u>Paid-in Capital</u>		<u>Earned capital</u>				<u>Results from holding nonmonetary assets from valuation of permanent investments in shares</u>	<u>Net income</u>	<u>Minority interest</u>	<u>Total stockholders' equity</u>
	<u>Capital stock</u>	<u>Additional paid-in capital</u>	<u>Statutory reserves</u>	<u>Results of prior years</u>	<u>Cumulative translation adjustment</u>	<u>Deficit in restatement of stockholders' equity</u>				
Balances at December 31, 2003	\$ 7,592,871	12,260,234	383,322	2,871,238	-	(3,706,178)	(3,566,087)	1,645,688	2,945	17,484,033
Changes resulting from stockholder resolutions (note20a):										
Resolution at the Ordinary General Stockholders' Meeting on April 27, 2004 Appropriation of the net income for 2003	-	-	82,285	1,563,403	-	-	-	(1,645,688)	-	-
Total items related to stockholders' decisions	-	-	82,285	1,563,403	-	-	-	(1,645,688)	-	-
Changes related to the recognition of comprehensive income (note 20b):										
Net income	-	-	-	-	-	-	-	3,370,586	-	3,370,586
Cumulative translation adjustment	-	-	-	-	(911)	-	-	-	-	(911)
Valuation effect of unconsolidated subsidiaries, associated and affiliated	-	-	-	-	-	-	(131,323)	-	-	(131,323)
Minority interest	-	-	-	-	-	-	-	-	237	237
Recognition of the year's effects of inflation	-	-	-	2,772	-	15,294	-	-	(152)	17,914
Total comprehensive income	-	-	-	2,772	(911)	15,294	(131,323)	3,370,586	85	3,256,503
Balances at December 31, 2004	7,592,871	12,260,234	465,607	4,437,413	(911)	(3,690,884)	(3,697,410)	3,370,586	3,030	20,740,536
Changes resulting from stockholder resolutions (note20a):										
Resolution at the Ordinary General Stockholders' Meeting on April 21, 2005 Appropriation of the net income for 2004	-	-	168,529	3,202,057	-	-	-	(3,370,586)	-	-
Total items related to stockholders' decisions	-	-	168,529	3,202,057	-	-	-	(3,370,586)	-	-
Changes related to the recognition of comprehensive income (note 20b):										
Net income	-	-	-	-	-	-	-	4,980,924	-	4,980,924
Cumulative translation adjustment	-	-	-	-	(6,108)	-	-	-	-	(6,108)
Valuation effect of unconsolidated subsidiaries, associated and affiliated	-	-	-	-	-	-	66,867	-	-	66,867
Minority interest	-	-	-	-	-	-	-	-	(730)	(730)
Recognition of the year's effects of inflation	-	-	-	-	-	1,735	-	-	-	1,735
Total comprehensive income	-	-	-	-	(6,108)	1,735	66,867	4,980,924	(730)	5,042,688
Balances at December 31, 2005	\$ 7,592,871	12,260,234	634,136	7,639,470	(7,019)	(3,689,149)	(3,630,543)	4,980,924	2,300	25,783,224

See accompanying notes to the consolidated financial statements.

"These consolidated statements of stockholders' equity, with those of the financial and other entities comprising the Financial Group that are subject to consolidation, were prepared in accordance with the accounting criteria for financial group holding companies issued by the National Banking and Securities Commission based on Article 30 of the Law that Regulates Financial Groups, which are of a general and mandatory nature and have been applied on a consistent basis. Accordingly, they reflect all the stockholders equity account entries relating to the transactions carried out by the Holding Company and the financial and other entities comprising the Financial Group that are subject to consolidation, for the years noted above. Furthermore, these transactions were carried out and valued in accordance with sound banking practices and the applicable legal and administrative provisions."

These consolidated statements of stockholders' equity were approved by the Board of Directors under the responsibility of the undersigned officers."

Signature _____
Alexander A. Flockhart
President and Chief Executive Officer

Signature _____
Germán Osuna Castelan
Chief Financial Officer

Signature _____
W. Graham Thomson
Director of Internal Audit

Signature _____
Sergio Armando Torres López
Chief Accountant

GRUPO FINANCIERO HSBC, S. A. de C. V.
Sociedad Controladora Filial
AND SUBSIDIARIES

Consolidated Statements of Changes in Financial Position

Years ended December 31, 2005 and 2004

(Thousands of Mexican pesos of constant purchasing power as of December 31, 2005)

	<u>2005</u>	<u>2004</u>
Operating activities:		
Net income	\$ 4,980,924	3,370,586
Items included in operations not requiring (providing) funds:		
Net unrealized loss from valuation of securities under repurchase/resell agreements, forwards and financial instruments	(273,817)	(59,388)
Allowance for loan losses	1,499,394	1,369,791
Equity in the results of unconsolidated subsidiaries, associated and affiliated companies	(675,389)	(228,482)
Depreciation and amortization	849,667	648,695
Deferred income tax and employee statutory profit sharing	1,346,079	1,269,443
Allowance for foreclosed assets	52,286	214,056
Minority interest	386	287
	<u>7,779,530</u>	<u>6,584,988</u>
Changes in items related to operations:		
Increase in operating liabilities:		
Deposit funding	27,134,144	26,308,086
Accounts payable	13,151,242	(18,128)
(Increase) decrease in operating assets:		
Loan portfolio	(19,838,383)	(53,183)
Investment securities	(9,140,634)	(22,336,816)
Securities and derivative transactions, net	4,004,529	(111,376)
Other accounts receivable	(11,566,140)	(202,995)
	<u>11,524,288</u>	<u>10,170,576</u>
Funds provided by operating activities		
Financing activities:		
(Redemption) placing of outstanding subordinated debentures	(95,869)	283,160
Decrease in due to banks and other institutions	(2,280,990)	(217,604)
	<u>(2,376,859)</u>	<u>65,556</u>
Funds used in financing activities		
Investing activities:		
Acquisition of premises, furniture and equipment, net	(1,974,753)	(1,536,454)
Permanent investments in shares, net	805,161	(260,074)
Currency translation adjustment	(6,108)	911
Decrease (increase) in deferred charges, net	115,466	(517,430)
Decrease in foreclosed assets	115,664	128,960
	<u>(944,570)</u>	<u>(2,184,087)</u>
Funds used in investing activities		
Minority Interest	(730)	84
Increase in cash and equivalents	8,202,129	8,052,129
Cash and equivalents:		
At beginning of year	47,089,168	39,037,039
At end of year	\$ <u>55,291,297</u>	<u>47,089,168</u>

See accompanying notes to the consolidated financial statements.

"These consolidated statements of changes in financial position have been prepared in conformity with the accounting criteria of the financial and other entities comprising the Financial Group that are subject to consolidation, were prepared in accordance with the accounting criteria for financial group holding companies issued by the National Banking and Securities Commission based on Article 30 of the Law that Regulates Financial Groups, which are of a general and mandatory nature and have been applied on a consistent basis. Accordingly, they reflect all sources and applications of funds derived from the transactions carried out by the Holding Company and the financial and other entities comprising the Financial Group that are subject to consolidation, for the years noted above. Furthermore, these transactions were carried out and valued in accordance with sound banking practices and the applicable legal and administrative provisions."

These consolidated statements of changes in financial position were approved by the Board of Directors under the responsibility of the undersigned officers.

Signature
Alexander A. Flockhart
President and Chief Executive Officer

Signature
Germán Osuna Castellán
Chief Financial Officer

Signature _____
W. Graham Thomson
Director of Internal Audit

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Sergio Armando Torres López
Chief Accountant

GRUPO FINANCIERO HSBC, S. A. DE C. V.
Sociedad Controladora Filial
AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

December 31, 2005 and 2004

(Thousands of Mexican pesos of constant purchasing power as of December 31, 2005,
except when indicated otherwise)

These consolidated financial statements have been translated from the Spanish language original solely for the convenience of foreign/English-speaking readers.

(1) Description of business and significant transactions-

Description of business-

Grupo Financiero HSBC, S. A. de C. V. (“the Financial Group”) is a subsidiary of HSBC Holdings plc. (HSBC), which currently holds 99.80% of its capital stock; it is authorized to buy and administer the voting stock issued by financial and brokerage entities, auxiliary credit institutions, and others entities primarily engaged in providing complementary services to one or more of these financial entities.

At December 31, 2005 the Financial Group and its consolidated subsidiaries (the Financial Group) is comprised of HSBC México, S. A. (HSBC or the Bank), authorized to engage in commercial banking transactions, which include but are not limited to: accepting deposits from the general public, granting and receiving loans, engaging in securities transactions and providing trust services; HSBC Bank Panamá, S. A. (HSBC Panamá), authorized to engage in banking transactions and other financial and trust-related activities; HSBC Casa de Bolsa, S. A. de C. V. (the Brokerage Firm) which acts as financial intermediary in transactions with authorized securities; HSBC Operadora de Fondos, S. A. de C. V., Sociedad Operadora de Sociedades de Inversión (Operadora) which provides administrative and operating services to mutual funds of the Financial Group; HSBC Afore, S. A. de C. V., (the Afore) whose primary purpose is to open, administer and operate individual retirement savings accounts. These entities are regulated by the National Banking and Securities Commission (the Banking Commission) and other applicable laws.

The Financial Group’s subsidiaries, not subject to consolidation according to the accounting criteria of the Banking Commission are: HSBC Seguros, S. A. de C. V. and HSBC Fianzas, S. A., which are controlled by the National Insurance and Bonding Commission and other applicable laws.

In Mexico, by Law, the Group has unlimited liability for the obligations and losses of each of its Mexican subsidiaries.

Significant transactions-

The Financial Group and the Bank (its principal subsidiary) carried out the following significant transactions:

Acquisition of Grupo Financiero Finacomer, S. A. and Subsidiaries.-

As explained in note 13 to the financial statements, on September 1, 2005 HSBC Bank (Panamá), S. A. acquired all the operations of Grupo Finacomer, S. A. and affiliated companies, which entailed acquiring assets, liabilities and stockholders’ equity amounting to USD 40, USD 28 and USD 12 million, respectively.

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GRUPO FINANCIERO HSBC, S. A. DE C. V.
Sociedad Controladora Filial
AND SUBSIDIARIES

On July 31, 2004 the Financial Group acquired from HSBC Bank USA 100% of the shares representing the capital stock of 15 branches, along with their respective assets and liabilities, that include 100% of the capital stock of Overseas Realty Corporation of Panamá, Panamá Realty Investment, S. A., HSBC Investment Corporation (Panamá), S. A. and HSBC Securities (Panamá), S. A., with assets, liabilities and stockholders' equity of USD 1,019, USD 895 and USD 124 million, respectively. For legal and statutory reasons, a new bank has been created from these companies, called HSBC Bank (Panamá), S. A.

(2) Summary of significant accounting policies-

(a) Financial statement presentation-

The consolidated financial statements have been prepared based on the banking legislation and in conformity with the accounting criteria for financial group holding companies in Mexico established by the National Banking and Securities Commission (the Banking Commission). The Banking Commission is responsible for the inspection and supervision of financial group holding companies and for reviewing their financial information. The financial statements of HSBC Panamá has been prepared in conformity with accounting principles generally accepted in the United States and according with the practice of banking industry.

The accompanying consolidated financial statements include the financial statements of the financial group and of its subsidiaries subject to consolidation. Significant intercompany transactions and balances have been eliminated on consolidation. The operations of HSBC Panamá only include the results from August 1, to December 31, 2004 (see note 13).

The consolidated financial statements also include the Bank's UDI-restructured loan portfolio trusts (UDI Trusts), which were created with the purpose of managing the restructured loan portfolio through the support programs established by the Federal Government (see note 9, section b), with the Bank acting as trustor and trustee and the Federal Government as beneficiary. The trusts have been valued and presented pursuant to the accounting rules prescribed by the Banking Commission.

In general, the accounting criteria established by the Banking Commission conform to accounting principles generally accepted in Mexico ("Mexican GAAP"), issued by the Mexican Institute of Public Accountants (IMCP) and include particular rules relating to accounting, valuation, presentation and disclosure, which in certain respects, differ from such principles in that they do not limit the consolidation to financial subsidiaries (also see paragraphs b, d and e of this note), and c for 2004, because as a result of changes to Bulletin C-2 of Mexican GAAP in 2005, it is consistent with the recording of the valuation in comprehensive income reported in results of operations.

For cases not contemplated therein, the accounting criteria include a process which provides for the supplementary use of other accounting principles and standards, in the following order: Mexican GAAP; International Financial Reporting Standards issued by the International Accounting Standards Board; accounting principles generally accepted in the United States; or in cases not covered by these principles and standards, any other formal and recognized accounting standard that does not contravene the general criteria of the Banking Commission.

(Continued)

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The accompanying consolidated financial statements are expressed in Mexican pesos of constant purchasing power, using the Investment Unit (UDI) value. The UDI is a unit of measurement whose value is determined by the Banco de México (Central Bank) based on inflation. UDI values at December 31 are as follows:

<u>Year</u>	<u>UDI</u>	<u>Annual inflation</u>
2005	\$ 3.6375	2.91%
2004	3.5347	5.45%
2003	3.3520	3.91%
	=====	

For purposes of disclosure in the notes to the consolidated financial statements, when reference is made to pesos or “\$”, it refers to Mexican pesos, and when reference is made to “US\$” or dollars, it means dollars of the United States of America.

Assets and liabilities related to purchase and sale of foreign currencies, investments in securities, securities repurchase and resell agreements, and derivative financial instruments are recognized in the consolidated financial statements on the day the transactions are entered into, regardless of the settlement date.

(b) Cash and equivalents-

Cash and equivalents consist of cash, precious metals (coins), bank account balances, 24 and 48-hour foreign currency purchase and sale transactions, bank loans with original maturities of up to three days (“Call Money”) and deposits with the Central Bank.

The receivables associated with 24 and 48-hour foreign currency sales are recorded in “Other accounts receivable” while the obligations arising from such foreign currency purchases are recorded in “Sundry creditors and other accounts payable”.

This category includes the deposits relation to monetary regulation, in compliance with the Law of the Banco de México (Central Bank), whose purpose is regulating the liquidity of the money market. These deposits do not have maturity and bear interest at the average funding rate of the banks. In accordance with Bulletin C-10 of Mexican GAAP beginning January 1st, 2005 any margin accounts are recorded under “Securities and derivative transactions” including cash and securities contributions and interest payable at maturity.

(c) Investment securities-

Investment securities consist of equities and government securities and bank notes, listed and unlisted, classified into three categories depending on management’s investment intentions. These categories are described on the following page.

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Trading securities-

Trading securities are bought and held principally to be sold in the near term. Debt and equity securities are initially recorded at cost and subsequently marked to market at the price provided by an independent price vendor. When a fair and representative market value cannot be determined, they are recorded at the latest fair value or otherwise the security is reported at cost plus accrued interest. Equity securities are reported at the lower of market value provided by an independent price vendor, by applying the equity method, acquisition cost restated using UDI factors, or their estimated net realizable value. Valuation effects are recognized in results of operations.

Available-for-sale securities-

Securities not classified as trading or held-to-maturity portfolios are classified as “Available-for-sale”. “Available-for-sale” securities are recorded at cost and valued in the same way as trading securities; however, the mark-to-market adjustment is reported in stockholders’ equity under “Unrealized gain or loss from valuation of Available-for-sale securities” caption. Unrealized gains and losses are cancelled when the respective securities are sold, reporting the difference between net realizable value and acquisition cost in results of operations. Where there is persuasive evidence that a security represents a high credit risk and/or the estimated value has decreased, the book value is written down through a charge to results of operations.

Held-to-maturity securities-

Held-to-maturity securities are those securities that the Bank has the ability and intent to hold until maturity, and that have defined payments and maturities of more than 90 days. Held-to-maturity securities are recorded at acquisition cost and interest is recognized in income as earned.

Transfers between categories-

Transfers of securities between categories, except transfers to the trading securities category, require express authorization from the Banking Commission. The cumulative effect of the “Unrealized gain or loss from valuation of “Available-for-sale securities” is cancelled and recognized in income upon transferring Available-for-sale” securities to the trading securities category. For transfers of “Available-for-sale” securities to the “held-to-maturity” securities category, the “Unrealized gain or loss from valuation of “Available-for-sale” securities is amortized to income based on the remaining term of the securities.

(d) *Securities under repurchase/resell agreements-*

Securities under repurchase/resell agreements are stated at market value provided by an independent price vendor and the obligations or rights from the commitments to repurchase or resell the securities are stated at the net present value at maturity. The balance sheet presents the sum of debit or credit balances after individually offsetting the restated values of the securities receivable or deliverable and the repurchase or resale commitment of each repurchase/resell agreement. Transactions where the Financial Group is both repurchaser and repurchasee with the same entity are not offset. Contrary to Mexican GAAP requirements, the consolidated balance sheet reflects the net balance between these two restated values, instead of presenting them separately as assets and liabilities and only offsetting similar transactions with the same party. Interest, premiums, gains or losses and valuation adjustments from these transactions are reported in the results of operations under “Interest income”, “Interest expense”, and “Financial intermediation income, net”, respectively.

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In accordance with the Circular 1/2003 of the Central Bank, any repurchase transactions, with a maturity period over 3 days; must include an obligation to guarantee such transaction, when the fluctuations in the value of the securities under the repurchase agreement represents a net exposure which exceeds the maximum amount agreed by the parts. The guarantee granted is recorded under the category of investment in securities as guaranteed trading securities or in the category of cash and equivalents as restricted funds. The guarantees received, which does not represent a transfer of property, are recorded in memorandum accounts as assets in custody or under management. Such guarantees are valued in accordance with current guidelines for investment securities, cash equivalents and assets in custody or under management, respectively.

Securities under repurchase/resell agreements that cannot be renegotiated with a third party are reported as secured borrowing or lending transactions. Premiums are recognized in income as they accrued, on a straight-line basis, throughout the term of the transaction.

(e) ***Derivative transactions-***

Transactions with derivative financial instruments comprise those carried out for trading or hedging purposes, the accounting treatment is described below:

Futures and forward contracts – The consolidated balance sheet shows the net fluctuation in the market value of the contracts' future price, these effects are recognized in income, except in the case of hedging transactions where the related gains or losses are recorded as deferred credits or debits, amortized using the straight-line method over the term of the underlying instruments and shown together with the primary position they cover.

Swaps – Rights or obligations established in the contract arising from the exchange of cash flows or asset yields (swaps) are recorded as assets or liabilities. The assets and liabilities derived from swaps are marked to market, reporting the net value of the swap on the consolidated balance sheet while the related gains or losses are recognized in income, except in the case of transactions designated as hedges where gains or losses are recorded as deferred credits or debits, amortized using the straight-line method over the term of the underlying instruments and shown together with the primary position they cover.

Options – Put and call option obligations (premiums collected) or rights (premiums paid) are recorded at contract value and marked to market, recording all gains or losses in income. Premiums collected or paid are recognized in “Financial intermediation income, net” when the option expires.

In conformity with Bulletin C-10 of Mexican GAAP, as from January 1, 2005, derivative financial instruments are reported at fair value, regardless of management's intention. Fair value is initially represented by the agreed-upon consideration. Transaction costs and cash flows received or given to adjust the instrument at the beginning of the transaction to fair value, not related to option premiums, are amortized during the term of the transaction. Changes in the fair value of derivative financial instruments for trading purposes are reported in operations as part of the comprehensive financial results.

Derivate financial instruments held for hedging purposes are presented in “Derivative financial instruments” and the fair value changes are recorded, depending on the hedge category (fair value, cash flow or foreign exchange) and depending on the effectiveness measurement either in income or other comprehensive income, are presented in the same line of the consolidated statement of operations where primary positions are recognized.

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(f) Clearing accounts-

Amounts receivable or payable arising from investment securities, securities under repurchase/resell agreements, securities lending and/or derivative financial instruments which have expired but have not been settled at the balance sheet date, as well as amounts receivable or payable resulting from the purchase or sale of foreign currencies which are not for immediate settlement or those with a same day value date, are recorded in clearing accounts.

Debit and credit balances of clearing accounts resulting from foreign currency purchase/sell transactions are offset provided the contractual right exists for offsetting the amounts recorded and there is the intention of settling them on a net basis, or else realizing the asset and liability simultaneously. Assets and liabilities are also offset in transactions of the same nature or that arise from the same contract, provided they have the same maturities and are settled concurrently.

(g) Past due loans and interest-

Outstanding loan and interest balances are classified as past due according to the following criteria:

Commercial loans with principal and interest payable upon maturity – 30 days after due date.

Commercial loans with one principal amortization and periodic interest payments – When interest or principal have not been collected 90 or 30 days after their due date, respectively.

Revolving credits, credit cards and others – When unpaid for two normal billing cycles or when 60 or more days past due.

Commercial loans with principal and interest installments – 90 days after the first unpaid amortization of principal and interest.

Mortgage loans – 90 days after the due date of the first unpaid installment.

Overdrafts from checking accounts without lines of credit – When the overdraft arises.

In addition, a loan is classified as past due when the debtor files for bankruptcy protection.

(h) Allowance for loan losses-

An allowance for loan losses is maintained which, in management's opinion, is sufficient to cover credit risks associated with the loan portfolio, guarantees issued and irrevocable loan commitments. The allowance is established as follows.

Rated loans – Based on studies which classify the loan portfolio, using an internally developed methodology for commercial loans. The Banking Commission in the official letter 601-II-DGSIFC-7651 dated January 27, 2005, authorized HSBC to continue using its internally developed methodology, for a 2 year period beginning December 1, 2004, that have been used in accordance with the official letters 601-II-DGSIFC-71841 and 601-II-DGSIFC-9867 dated April 23, 2003 and March 16, 2004, respectively.

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HSBC's internally developed methodology links the attributes used with the attributes established in the Banking Commission included in the "General Dispositions relating to the Rating Methodology for Loan Portfolios of Credit Institutions" ("the Dispositions") and published in the Official Gazette on August 20, 2004, which took effect starting December 1, 2004. Such dispositions excluded loans granted to Government states or municipalities, investment projects with own source of payment and trustees of the trusts or structured credit schemes with own net worth. These Dispositions also allow individual assessment of the associated risk, individually evaluated in accordance with the methodology prescribed by the Dispositions, including residential mortgages and other consumer loans (see note 26). The allowance percentages are established considering risk levels according to the following table:

<u>Risk level</u>	<u>Range of allowance percentages</u>
A - Minimum	0.5 – 0.9
B - Low	1 – 19.9
C - Medium	20 – 59.9
D - High	60 – 89.9
E - Loss	90 – 100.0

The Dispositions supersede the circulars 1449, 1460, 1480, 1493, 1494 and 1514 of the Banking Commission. The Dispositions establish new rules to record credit provisions for potential losses of credit loans and to recognize potential losses, due to time, in the value of the foreclosed assets or received in lieu of payment (see note 2j). The adoption of the dispositions did not have an impact on the credit allowance, because they are very similar to the internal developed methodology of HSBC. In the case of foreclosed assets or assets received in lieu of payment, an increase of the allowance was recorded in 2004 for \$113,906 charged against that year's results (see note 10).

General reserves – In accordance with the Dispositions to be loans general reserves with risk grade A.

Specific reserves – Considered for loans with risk grade B, C, D and E.

Exempt portfolio – consists mainly of loans to government entities, including the IPAB, that are not rated.

Impaired loans – consist of commercial loans (principal and interest) which, based on information and current facts, as well as on the process to review loans, are not likely to be fully recovered as set forth in the agreement. Both, current and past due portfolios may be identified as impaired loans. For consolidated financial statement disclosure purposes, "impaired loans" are those commercial loans classified by HSBC as having the risk levels "D" and "E".

Additional reserves – are established for those loans, which in management's opinion, may give rise to concern in the future given the particular situation of the customer, the industry or the economy. They also include items such as uncollected ordinary interest and others, the ultimate collection of which may, in management's opinion, result in a loss for the Financial Group.

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Loans considered irrecoverable are written off against the allowance when their collection is determined to be impractical. Recoveries on loans previously written off are credited to the allowance.

(i) Other accounts receivable-

Reserves are established, based on an evaluation of the levels of risk, for accounts receivable arising from unidentified and identified non-credit transactions that are not recovered within 60 and 90 days, respectively.

(j) Foreclosed assets and assets received in lieu of payment-

Assets acquired through foreclosure are stated as the lower value between of the adjudicated value or net realizable value. Assets received in lieu of payment are stated at the lower of the appraisal value or the price agreed upon by the parties. Any shortfall between the appraisal value and the balance due is written off against the allowance for loan losses. Assets are written down to reflect any subsequent impairment in their value through a charge against the results of the operations. The assets with commitment of sale are shown at the sale price, recognizing the gain or loss in deferred credit or in the income, respectively. The amount of the collected rents derived from foreclosed assets is deducted against the value of the assets.

Up to November 30, 2004, the write-downs and reserves are deducted from the carrying value of the assets and charged to results of operations. Effective December 1, 2004, the Bank creates additional reserves on a quarterly basis to recognize potential losses for the deterioration in asset value due to the passing of time. These reserves are created in accordance with the Dispositions described in note 2(h) and provisions are established as follows:

<u>Elapsed months since the date of foreclosure or lieu of payment</u>	<u>Percentage of the allowance</u>	
	<u>Premises</u>	<u>Sundry assets</u>
More than: 6	0	10
12	10	20
18	10	45
24	15	60
30	25	100
36	30	100
42	35	100
48	40	100
54	50	100
60	100	100

(k) Premises, furniture and equipment-

Premises, furniture and equipment are initially recorded at acquisition cost, and adjusted for inflation by applying UDI factors.

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Depreciation and amortization are calculated on the restated asset values using the straight-line method over the estimated useful lives of the assets.

(l) *Permanent investments in shares-*

The investments in subsidiary companies not subject to consolidation are accounted for under the equity method. The Financial Group's equity in the results of subsidiary companies is recognized in the year's income and its equity in the increase or decrease of other stockholders' equity accounts is recognized in the Financial Group's stockholders' equity under the caption "Results from holding non-monetary assets from valuation of permanent investments in shares".

This category also includes permanent investments in shares of issuing companies where the Financial Group exerts no significant influence, which are valued using the cost method and differs from Mexican GAAP, adjusted for inflation by applying the UDI value. Valuation adjustments are recognized in the Financial Group's stockholders' equity under "Results from holding non-monetary assets from valuation of permanent investments in shares". When the valuation of the investment is consistently below the adjusted cost, the investment is written down to realizable value through a charge to results of operations.

(m) *Other assets, deferred charges and intangibles-*

This line item includes under other assets, recoverable balances of taxes pending to be offset or recovered; under deferred charges, the prepayment of labor obligations and other expenses pending amortization arising from services and commissions paid in advance, whose amortization is made straight line over the term of the related transaction; and under intangible assets, financial costs for debt issuance or placement, which are amortized straight line over the term of the issuance.

(n) *Deferred income tax (IT) and employee statutory profit sharing (ESPS)-*

IT and ESPS payable for the year are determined in conformity with tax regulations in force.

Deferred income tax is accounted for under the asset and liability method which compares accounting and tax values. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as for unamortized tax loss carryforwards and unused tax credits. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in results of operations for the period the change is enacted.

Deferred ESPS is recognized for timing differences arising from the reconciliation between book and taxable for profit sharing purposes, on which it may reasonably be estimated that a future liability will arise and there is no indication that the liabilities will not materialize.

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(o) ***Goodwill-***

Goodwill of subsidiary companies represents the excess of the acquisition value of the companies over the identified amount of their tangible and intangible assets. In determining this amount, intangible assets acquired, with no recoverable value, are eliminated, and the remainder is restated using UDI factors. As of 2004, goodwill is amortized straight-line over a maximum 15-year term. However as of January 1, 2005, goodwill will no longer be amortized but instead be tested for impairment (see note 13) based on Bulletin C-15 of Mexican GAAP at least annually.

(p) ***Deposit funding-***

Deposit funding comprises demand and time deposits of the general public, as well as money market funding. Interest is charged to expense on the accrual basis. For instruments sold at a price other than face value, a deferred charge or credit is recognized and the difference is amortized on the straight-line basis over the term of the respective instrument.

(q) ***Due to banks and other institutions-***

Bank and other loans comprise short and long-term bank loans from domestic and foreign banks, loans obtained through credit auctions with Banco de México and development fund financing. In addition, this category includes loans rediscounted with agencies specializing in financing economic, productive or development activities. Interest is recognized on the accrual basis.

(r) ***Securities lending-***

The Financial Group conducts securities lending as a borrower. The securities borrowed are guaranteed by the Financial Group and the term of each transaction is one working day. The Financial Group pays the lender a premium for each security lent, which is eliminated on maturity or on the roll over of the transaction. The securities loan values and the guaranteed are stated at market value provided by an independent price vendor.

(s) ***Pensions, seniority premiums, post-retirement benefits and compensations upon termination of labor relationship-***

It consists of defined benefit (DBO) and defined contribution (DCO) obligations. As regards DBO, the net periodic cost, pension, seniority premium benefits, other post-retirement plans, and, beginning 2005 (see note 3), severance compensation for reasons other than restructuring, to which employees are entitled in accordance with the law are charged to operations for the year based on actuarial computations of the present value of these obligations using the projected unit credit method and real interest rates, according to Bulletin D-3 of Mexican GAAP. Pension DCO are expensed as incurred. Other compensation to which employees may be entitled is charged to operations as incurred.

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Beginning January 1, 2005, Bulletin D-3 issued by the Mexican Institute of Public Accountants established a new provision that includes a reserve for compensation to employees upon termination of the labor relationship (statutory compensation benefits), for reasons other than restructuring. Through December 31, 2004, all other compensation to which employees were entitled in case of employment termination or disability, were charged to operations as incurred. The adoption of this change did not have a material effect on the results of operations.

In addition, based on the calculations performed by an independent actuary, a liability is recorded, recognizing the cost of the period in the income. HSBC funds the post retirement medical benefits as of 2002. Amortization of unrecognized past service costs is based on an estimated service life of employees of 25 years.

(t) Restatement of capital stock and statutory reserves-

This restatement is determined by multiplying stockholder contributions, statutory reserves and retained earnings (deficit) by UDI factors, which measure accumulated inflation from the dates contributed or generated through the most recent year end. The resulting amounts represent the constant value of stockholders' equity.

(u) Results from holding non-monetary assets-

The result from holding non-monetary assets represents the difference between the specific valuations of these assets and their cost restated based on the value of the UDI.

(v) Monetary position gains and losses-

The Financial Group recognizes in income the effect (gain or loss) in the purchasing power of its monetary position, which it determines by multiplying the difference between monetary assets and liabilities at the beginning of each month by inflation through year end. The aggregate of these results represents the monetary gain or loss for the year arising from inflation, which is reported in results of operations for the year.

The gain or loss from interest-bearing monetary assets and liabilities is included in the consolidated statement of operations as part of the "Financial margin", while the gain or loss from all other monetary items and the acquisition cost of "Available-for-sale" securities is presented in "Other income" or "Other expense", respectively.

The monetary position gain or loss from the valuation of "Available-for-sale" securities is recognized in the Bank's stockholders' equity under "Unrealized gain or loss from valuation of Available-for-sale securities".

(w) Revenue recognition-

Interest on loans granted is recorded in income as earned. Interest on past due loans is not recognized in income until collected.

Fees and interest collected in advance are recorded as deferred income under "Deferred credits", and recognized in results of operations as earned.

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Fees related to the issuance of credit cards and services rendered, and those corresponding to commercial, personal and mortgage loans are recorded in income upon collection. In the case of loans subject to fees and conditioned to the occurrence of a particular event, fees are deferred and recognized in income over the term of the loan.

Premiums collected on securities repurchase transactions are recognized in income based on the present value of the price at maturity.

(x) Foreign currency transactions-

The accounting records are maintained in both pesos and foreign currencies, which for financial statement presentation purposes, in the case of currencies other than the dollar are translated from the respective currency to dollars as established by the Banking Commission, and the dollar equivalence with Mexican currency is translated at the exchange rate established by the Central Bank. Foreign exchange gains and losses are recognized in the results of operations.

(y) UDI Trusts-

Asset and liability accounts of the loan portfolios restructured in UDI Trusts are expressed in pesos by applying the UDI value determined by the Central Bank at the end of each month. Income and expense accounts are expressed in pesos by applying the average UDI value.

(z) Contributions to the Bank Savings Protection Institute (IPAB)-

Among other provisions, the Bank Savings Protection Law created the IPAB, whose purpose is to establish a system to protect the savings of the public and regulate the financial support granted to banking institutions in order to comply with this objective. During 2004, the IPAB guaranteed an amount equivalent to 5,000,000 UDIS. Beginning in January 1, 2005, the IPAB will guarantee a maximum of 400,000 UDIS per depositor per institution, in conformity with the decree published in the Official Gazette on December 14, 2000. The Financial Group recognizes in results of operations the mandatory contributions to the IPAB.

(aa) Contingencies-

Liabilities for loss contingencies are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. When a reasonable estimation cannot be made, qualitative disclosure is provided in the notes to the consolidated financial statements. Contingent revenues, earnings and assets are not recognized until their realization is virtually assured.

(ab) Impairment of premises, furniture and equipment-

The Financial Group evaluates periodically the adjusted values of property, plant and equipment to determine whether there is an indication of potential impairment. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net revenues expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated net revenues, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheets and reported at the lower of the carrying amount or realizable value.

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(ac) Use of estimates-

The preparation of consolidated financial statements requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

(3) Changes in accounting policies-

Embedded derivatives-

Bulletin C-10 of Mexican GAAP establishes additional and more precise rules for accounting of derivative financial instruments (including those embedded derivatives associated with other transactions such as the purchase and sale of goods or services, funding, etc. contracted with underlying securities) and changes the provisions for hedge accounting prescribed by Bulletin C-2. In addition, this Bulletin enhances disclosure requirements relating to the exposure to financial risks of an entity. The adoption of this Bulletin did not have a material effect.

Labor obligations-

Beginning January 1, 2005, HSBC adopted the new provision of Bulletin D-3 of Mexican GAAP, Labor Obligations, issued by the IMCP, relating to the recognition of compensation liabilities payable to workers upon termination of labor relationship before retirement age (statutory compensation benefits) for reasons other than restructuring. The foregoing is determined based on computations prepared by independent actuaries, using the projected unit credit method and real interest rates. At the time HSBC adopted this new provision in conformity with the option that was set forth, there is an unamortized asset and a liability in the amount of \$267,606, which will be amortized over the average remaining service life of those employees expected to receive said compensation, and also an increase in expenses for the year of \$29,687.

(4) Foreign currency exposure-

Central Bank regulations require that banks and brokerage firms maintain balanced positions in foreign currencies within certain limits. The short or long position permitted by the Central Bank is equal to a maximum of 15% of the basic capital. At December 31, 2005 and 2004 the foreign currency position, in thousands of dollars is analyzed as follows:

	<u>(Thousands of dollars)</u>	
	<u>2005</u>	<u>2004</u>
Assets	19,327,161	10,363,842
Liabilities	<u>19,399,588</u>	<u>10,164,988</u>
Net (short) long position	(72,427) =====	198,854 =====

The exchange rate of the peso to the dollar as of December 31, 2005 and 2004 was \$10.6344 and \$11.1495, respectively.

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(5) Cash and equivalents-

At December 31, 2005 and 2004, cash and equivalents are analyzed as follows:

	<u>2005</u>	<u>2004</u>
Cash on hand	\$ 9,494,117	8,949,755
Deposits with domestic and foreign banks	7,627,730	12,618,500
Deposits with Central Bank	27,509,776	23,069,047
Bank loans with maturity up to three days	7,371,471	-
Other funds available	348,117	226,820
Restricted funds:		
24 and 48-hour foreign currency purchases	15,383,124	3,896,041
24 and 48-hour foreign currency sales	<u>(12,443,038)</u>	<u>(1,670,995)</u>
	\$ 55,291,297	47,089,168
	=====	=====

At December 31, 2005 and 2004 there are precious metals for \$26,351 and \$24,187, respectively, which are included in other funds available.

According to the Central Bank's monetary policy, HSBC is required to maintain a monetary regulation deposit which at December 31, 2005 and 2004 amounted to \$27,401,427 and \$23,027,871, respectively, in compliance with the requirements of the Central Bank, designed to control money market liquidity. These deposits earn interest at the average rate of banking deposits.

At December 31, 2005, HSBC had bank loans (Call Money) maturing in 3 days, which bore interest at a rate of 8.25% per annum.

(6) Investment securities-

At December 31, 2005 and 2004 the investments in securities were as follows:

	<u>2005</u>	<u>2004</u>
<u>Trading:</u>		
Debt securities	\$ 52,922	39,175
Bank promissory notes	1,225,923	2,040,218
Government securities (see note 7)	5,652,104	253,008
Bonds	-	688,350
Shares	<u>14,035</u>	<u>43,504</u>
Trading carried forward	\$ 6,944,984	3,064,255

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	<u>2005</u>	<u>2004</u>
Trading brought forward	\$ <u>6,944,984</u>	<u>3,064,255</u>
<u>Available-for-sale:</u>		
Equities	188,658	18,935
Debt securities (*)	<u>45,832,955</u>	<u>40,314,705</u>
	<u>46,021,613</u>	<u>40,333,640</u>
<u>Held-to-maturity:</u>		
Special CETES of the UDI Trusts (see note 9b):		
Productive plant	182,328	171,330
States and municipalities	399,787	374,802
Residential mortgages	<u>2,784,516</u>	<u>2,583,241</u>
	3,366,631	3,129,373
Other	<u>626,624</u>	<u>1,018,133</u>
	<u>3,993,255</u>	<u>4,147,506</u>
Total investment securities	\$ <u>56,959,852</u>	<u>47,545,401</u>

At December 31, 2005, the surplus of special CETES of national productive plant and states and municipalities, are no longer to the collection of the portfolio of UDI trusts.

(*) Transactions of the Interbank Electronic Payments System (SPEI, formerly SPEUA)-

During 2005, the Central Bank implemented a new System of Interbank Electronic payments (SPEI, formerly system of electronic payments of extended use or SPEUA) superceding the Central Bank telefax circular 21/2003, that required that the participant institutions had to constitute guarantees with governmental values (Cetes, Bondes, Udibonos). To comply with the abovementioned, at December 31, 2004, HSBC had accumulated guarantees of \$901,858 with the Central Bank that covered the 85% required.

Transfer between investment categories-

During 2005, HSBC did not make any transfers between investment categories. In 2004, the Banking Commission authorized the transfer from "Trading securities" to "Available for sale" of UMS bonds and PEMEX bonds amounting \$55,941 and \$29,465, respectively.

As of December 31, 2005 and 2004, the investment in debt securities of the same issues other than government securities, greater than \$1,076 and \$765 millions (5% of the net capital of HSBC), classified as "Trading" and "Available-for-sale", are analyzed on the following page.

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<u>Issue</u>	<u>Thousands of securities</u>	<u>Partial amount</u>	<u>Total</u>
<u>2005</u>			
<i>Available for sale</i>			
IBANSAN 6011	1,585,433	\$ 1,584,707	
IINBURSA 6264	2,082,147	2,001,543	\$ 3,586,250
		=====	=====

<u>2004</u>			
<i>Trading</i>			
IBANOBAS 05011	1,983,994	\$ 2,040,225	\$ 2,040,225
		=====	=====

Classification of investment securities-

At December 31, 2005 and 2004 the investment securities are classified depending on management's intentions considering their term as follows:

<u>Securities</u>	<u>2005</u>		<u>2004</u>	
	<u>Short</u>	<u>Long</u>	<u>Short</u>	<u>Long</u>
Trading	\$ 1,833,711	5,111,273	2,970,133	94,122
Available-for-sale	963,626	45,057,987	363,445	39,970,195
Held-to-maturity	<u>62,188</u>	<u>3,931,067</u>	<u>67,513</u>	<u>4,079,993</u>
	\$ 2,859,525	54,100,327	3,401,091	44,144,310
	=====	=====	=====	=====
	\$ 56,959,852		47,545,401	
	=====		=====	

(7) Securities under repurchase/resell agreements-

At December 31, 2005 and 2004, the net debt and credit balances arising from the offsetting of each repurchase/resell agreements transaction, are analyzed on the following page.

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	2005			2004		
	Net balance		Total	Net balance		Total
	Debit	Credit		Debit	Credit	
Securities receivable	\$ 31,683,571	12,750,919	44,434,490	33,549,919	6,226,604	39,776,523
Creditors under agreements to repurchase	(31,589,051)	(12,860,869)	(44,449,920)	(33,505,981)	(6,243,235)	(39,749,216)
Securities sold under agreements to repurchase	<u>94,520</u>	<u>(109,950)</u>	<u>(15,430)</u>	<u>43,938</u>	<u>(16,631)</u>	<u>27,307</u>
Securities deliverable	(10,832,182)	(5,023,222)	(15,855,404)	(3,985,026)	(4,850,877)	(8,835,903)
Debtors under agreements to resell	<u>10,923,735</u>	<u>5,020,143</u>	<u>15,943,878</u>	<u>4,009,982</u>	<u>4,826,114</u>	<u>8,836,096</u>
Securities purchased under agreements to resell	<u>91,553</u>	<u>(3,079)</u>	<u>88,474</u>	<u>24,956</u>	<u>(24,763)</u>	<u>193</u>
Debit (credit) balances under repurchase/resell agreements	\$ <u>186,073</u>	<u>(113,029)</u>		<u>68,894</u>	<u>(41,394)</u>	

At December 31, 2005 and 2004, the Financial Group had executed repurchase/resell agreements and had net positions by type of security and average term in days as follows:

	2005				2004			
	Sale	Purchase	Average selling term	Average purchase term	Sale	Purchase	Average selling term	Average purchase term
<u>Securities receivable (deliverable)</u>								
<u>Government</u>								
BONDE182	\$ 11,331,874	(10,111,633)	25	27	7,318,503	(3,106,066)	28	32
BONDEST	-	-	-	-	656,961	(517,407)	20	28
BONOS	3,176,983	(2,896,689)	20	29	2,805,774	-	3	-
BPAT	4,529,169	(428,552)	22	28	6,759,647	(2,396,654)	21	3
BREMS	8,081,095	(2,129,530)	24	-	11,701,302	(866,460)	9	-
CETES	14,036,810	(273,000)	5	-	1,260,419	(235,578)	6	28
IPAB	1,601,002	-	35	-	4,939,546	(295,239)	22	28
<u>Bank</u>								
Promissory notes	1,677,557	(16,000)	7	-	2,432,617	-	7	-
Bonds	-	-	-	-	1,901,754	(1,418,499)	77	-
	<u>44,434,490</u>	<u>(15,855,404)</u>			<u>39,776,523</u>	<u>(8,835,903)</u>		
(Creditors) debtors under agreements to repurchase /resell	<u>(44,449,920)</u>	<u>15,943,878</u>			<u>(39,749,216)</u>	<u>8,836,096</u>		
	<u>(15,430)</u>	<u>88,474</u>			<u>27,307</u>	<u>193</u>		
Reclassifications	<u>201,503</u>	<u>(201,503)</u>			<u>41,587</u>	<u>(41,587)</u>		
Debit (credit) balances under repurchase/resell agreements	\$ <u>186,073</u>	<u>(113,029)</u>			<u>68,894</u>	<u>(41,394)</u>		

(Continued)

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(8) Derivative transactions-Trading:

At December 31, 2005 and 2004, the fair value of derivative financial instruments for trading purposes are analyzed as follows:

	<u>2005</u>			<u>2004</u>		
	<u>Purchase</u>	<u>Sale</u>	<u>Net</u>	<u>Purchase</u>	<u>Sale</u>	<u>Net</u>
Contracts:						
Foreign exchange forwards (mainly pesos and dollars)	\$ 142,229,279	(142,122,033)	107,246	48,606,997	(48,586,220)	20,777
Interest rate futures	-	-	-	346	-	346
Interest rate options	45,941	-	45,941	-	-	-
Cross currency swaps	1,721,848	(1,711,864)	9,984	-	-	-
Interest rate swaps	<u>28,562,405</u>	<u>(28,343,652)</u>	<u>218,753</u>	<u>3,798,585</u>	<u>(3,776,417)</u>	<u>22,168</u>
	<u>\$ 172,559,473</u>	<u>(172,177,549)</u>	<u>381,924</u>	<u>52,405,928</u>	<u>(52,362,637)</u>	<u>43,291</u>

As of December 31, 2004, as explained in note 6; the Banking Commission authorized a transfer from "Trading Securities" to "Available-for-sale". As result of this transfer, the cross currency swaps were reclassified from trading to hedging purposes.

Hedge transactions:

The fair value of derivative transactions for hedging purposes are presented in the consolidated balance sheet together with the primary position they cover. At December 31, 2005 and 2004, the fair value of derivative financial instruments for hedging purposes are analyzed as follows:

<u>Underlying</u>	<u>Primary position</u>	<u>Valuation</u>	
		<u>2005</u>	<u>2004</u>
Cross currency swaps	Investment securities (note 6)	\$ 19,837	(92,839)
Interest rate swaps	Loans to the IPAB (note 9b)	-	(1,720)
Interest rate	Investment securities	-	442,528
		=====	=====

Notional amounts:

Notional amounts of contracts represent the derivatives volume outstanding and not the potential gain or loss associated with the market risk or credit risk of such instruments. The notional amounts represent the amount to which a rate or price is applied for determining the amount of cash flows to be exchanged. Notional amounts of the derivative financial instruments at December 31, 2005 and 2004, are analyzed on the following page.

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	<u>2005</u>			<u>2004</u>		
	<u>Purchase</u>	<u>Sale</u>	<u>Net</u>	<u>Purchase</u>	<u>Sale</u>	<u>Net</u>
<u>Hedging purposes</u>						
<u>Interest rate contracts:</u>						
Swaps	\$ 156,000	-	156,000	4,376,000	(3,000,000)	1,376,000
<u>Foreign currency:</u>						
Swaps	<u>319,032</u>	<u>(3,205,930)</u>	<u>(2,886,898)</u>	<u>826,175</u>	<u>-</u>	<u>826,175</u>
	\$ <u>475,032</u>	<u>(3,205,930)</u>	<u>(2,730,898)</u>	<u>5,202,175</u>	<u>(3,000,000)</u>	<u>2,202,175</u>
<u>Trading purposes</u>						
<u>Interest rate contracts:</u>						
Futures	-	(22,638,100)	(22,638,100)	8,500,000	-	8,500,000
Options	1,329,300	-	1,329,300	-	-	-
Swaps	<u>34,822,996</u>	<u>(143,443,816)</u>	<u>(108,620,820)</u>	<u>14,680,000</u>	<u>(13,435,000)</u>	<u>1,245,000</u>
	36,152,296	(166,081,916)	(129,929,620)	23,180,000	(13,435,000)	9,745,000
<u>Foreign currency:</u>						
Forwards	-	-	-	21,798,566	(25,356,523)	(3,557,957)
Inflation effect	-	-	-	<u>1,459,632</u>	<u>(1,215,610)</u>	<u>244,022</u>
	\$ <u>36,627,328</u>	<u>(169,287,846)</u>	<u>132,660,518</u>	<u>51,640,373</u>	<u>(43,007,133)</u>	<u>8,633,240</u>

(9) Loan portfolio-

At December 31, 2005 and 2004 the loan portfolio and the credit commitments are analyzed as follows:

	<u>2005</u>	<u>2004</u>
Total loan portfolio, shown in the consolidated balance sheet	\$ <u>139,199,040</u>	<u>121,720,945</u>
Recorded in memorandum accounts (note 21a):		
Guarantees	56,717	224,156
Irrevocable lines of credit	<u>3,761,174</u>	<u>2,256,557</u>
	<u>3,817,891</u>	<u>2,480,713</u>
	\$ <u>143,016,931</u>	<u>124,201,658</u>

(a) Classification of current and past due loan portfolio by currency, rated portfolio, economic sector and by aging of past due loans-

At December 31, 2005 and 2004, the classification of current and past due loan portfolio by currency, which includes the restructured portfolio of UDI Trusts, and by economic sector, rated portfolio and aging of past due loans is shown on the following page.

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Notes to Consolidated Financial Statements

December 31, 2005 and 2004

(Thousands of Mexican pesos of constant purchasing power as of December 31, 2005)

Portfolio	Commercial		Financial institutions		Consumer		Residential mortgages		Government entities		IPAB		Past due indebtedness		Total	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Current:																
Pesos	\$ 29,289,307	19,629,364	6,573,479	3,623,331	23,954,422	15,141,219	9,721,159	5,863,853	34,493,155	5,319,595	1,096,145	43,019,797	-	-	105,127,667	92,597,159
Foreign currency	15,819,700	10,942,551	322,242	646,114	1,705,956	1,339,023	4,784,397	4,289,032	1,290,047	754,063	-	-	-	-	23,922,342	17,970,783
UDIS	641,963	758,065	-	-	6	7	5,593,770	6,487,205	379,255	404,757	-	-	-	-	6,614,994	7,650,034
Total	45,750,970	31,329,980	6,895,721	4,269,445	25,660,384	16,480,249	20,099,326	16,640,090	36,162,457	6,478,415	1,096,145	43,019,797	-	-	135,665,003	118,217,976
Past due:																
Pesos	1,036,262	992,674	302	311	806,490	539,570	286,197	258,209	-	-	-	-	27,323	40,817	2,156,574	1,831,581
Foreign currency	476,082	667,707	-	-	10,632	8,456	66,642	68,025	-	-	-	-	452	1,363	553,808	745,551
UDIS	154,871	333,172	-	-	286	287	668,498	592,378	-	-	-	-	-	-	823,655	925,837
Total	1,667,215	1,993,553	302	311	817,408	548,313	1,021,337	918,612	-	-	-	-	27,775	42,180	3,534,037	3,502,969
Total:																
Pesos	30,325,569	20,622,038	6,573,781	3,623,642	24,760,912	15,680,789	10,007,356	6,122,062	34,493,155	5,319,595	1,096,145	43,019,797	27,323	40,817	107,284,241	94,428,740
Foreign currency	16,295,782	11,610,258	322,242	646,114	1,716,588	1,347,479	4,851,039	4,357,057	1,290,047	754,063	-	-	452	1,363	24,476,150	18,716,334
UDIS	796,834	1,091,237	-	-	292	294	6,262,268	7,079,583	379,255	404,757	-	-	-	-	7,438,649	8,575,871
Total	\$ 47,418,185	33,323,533	6,896,023	4,269,756	26,477,792	17,028,562	21,120,663	17,558,702	36,162,457	6,478,415	1,096,145	43,019,797	27,775	42,180	139,199,040	121,720,945

Classification by activity

Manufacturing	\$ 18,657,921	12,596,177	-	-	-	-	-	-	-	-	-	-	-	-	18,657,921	12,596,177
Agriculture, forestry and fishing	7,491,521	6,912,861	-	-	-	-	-	-	-	-	-	-	-	-	7,491,521	6,912,861
Trade and tourism	12,801,044	8,955,849	-	-	-	-	-	-	-	-	-	-	-	12,801,044	8,955,849	
Services	8,467,699	4,858,646	-	-	-	-	-	-	-	-	-	-	-	8,467,699	4,858,646	
Financial services	-	-	6,047,378	3,325,266	-	-	-	-	-	-	-	-	-	6,047,378	3,325,266	
Credit Unions	-	-	420,537	518,988	-	-	-	-	-	-	-	-	-	420,537	518,988	
Lessors	-	-	265,041	234,407	-	-	-	-	-	-	-	-	-	265,041	234,407	
Others to financial organizations	-	-	163,067	191,095	-	-	-	-	-	-	-	-	-	163,067	191,095	
Credit Car	-	-	-	-	14,143,302	8,422,106	-	-	-	-	-	-	-	14,143,302	8,422,106	
Credit Card	-	-	-	-	7,675,696	4,510,330	-	-	-	-	-	-	-	7,675,696	4,510,330	
Multicredito	-	-	-	-	2,103,364	2,899,358	-	-	-	-	-	-	-	2,103,364	2,899,358	
Fixed payment	-	-	-	-	2,555,430	1,196,768	-	-	-	-	-	-	-	2,555,430	1,196,768	
Construction and housing	-	-	-	-	-	-	21,120,663	17,558,702	-	-	-	-	-	21,120,663	17,558,702	
Municipalities	-	-	-	-	-	-	-	-	399,728	690,190	-	-	-	399,728	690,190	
States	-	-	-	-	-	-	-	-	2,329,933	1,579,702	-	-	-	2,329,933	1,579,702	
Credit to the Federal Government (support programs)	-	-	-	-	-	-	-	-	374,419	426,103	-	-	-	374,419	426,103	
Other to governmental entities	-	-	-	-	-	-	-	-	33,058,377	3,782,420	-	-	-	33,058,377	3,782,420	
Simple loans	-	-	-	-	-	-	-	-	-	-	24,763,131	-	-	-	24,763,131	
Loan swap	-	-	-	-	-	-	-	-	-	-	1,096,145	18,256,666	-	-	1,096,145	18,256,666
Past due indebtedness	-	-	-	-	-	-	-	-	-	-	-	-	27,775	42,180	27,775	42,180
Total	\$ 47,418,185	33,323,533	6,896,023	4,269,756	26,477,792	17,028,562	21,120,663	17,558,702	36,162,457	6,478,415	1,096,145	43,019,797	27,775	42,180	139,199,040	121,720,945

Past due loans by aging

From 1 to 180 days	\$ 319,977	309,024	-	3	690,987	385,572	266,043	164,808	-	-	-	-	27,323	35,152	1,304,350	894,559
From 181 to 365 days	309,733	132,104	-	-	108,119	69,369	289,141	220,875	-	-	-	-	-	734	706,993	423,082
From 1 to 2 years	236,919	288,686	-	-	15,749	8,896	249,131	292,630	-	-	-	-	-	1,770	501,799	591,982
More than 2 years	805,566	1,263,739	302	308	2,553	84,476	217,022	240,299	-	-	-	-	452	4,524	1,020,895	1,593,346
Total	\$ 1,667,215	1,993,553	302	311	817,408	548,313	1,021,337	918,612	-	-	-	-	27,775	42,180	3,534,037	3,502,969

Loan portfolio rated

Portfolio rating risk %	Commercial		Financial institutions		Consumer		Residential mortgages		Government entities		IPAB		Past due indebtedness		Total	
0.5 a - 09 A-Minimum	\$ 28,277,403	30,717,548	3,286,392	4,161,372	22,493,248	13,632,946	18,617,368	13,337,646	5,816,160	5,054,777	-	-	-	-	78,490,571	66,904,289
1 a 19.9 B-Low	20,596,724	1,976,352	3,605,814	108,073	2,537,640	2,176,513	1,560,098	3,335,355	747,272	885,666	-	-	-	-	29,447,548	8,481,959
20 a 59.9 C-Medium	748,797	1,117,614	3,514	-	594,438	493,757	184,027	183,785	14,822	111,871	-	-	-	-	1,545,598	1,907,027
60 a 89.9 D-High	419,797	801,218	-	-	758,235	647,586	694,398	557,174	56,803	-	-	-	-	-	1,929,233	2,005,978
90 a 100 E-Irrecoverable	793,380	1,191,515	302	311	94,232	77,760	64,773	144,741	-	-	-	-	27,775	42,180	980,462	1,456,507
Total	51,236,101	35,804,247	6,896,022	4,269,756	26,477,793	17,028,562	21,120,664	17,558,701	6,635,057	6,052,314	-	-	27,775	42,180	112,393,412	80,755,760
Allowance																
0.5 a - 09 A-Minimum	175,019	190,189	29,883	24,440	249,359	104,662	123,137	77,683	41,697	32,098	-	-	-	-	619,095	429,072
1 a 19.9 B-Low	1,236,193	313,540	178,512	21,603	247,521	190,247	56,544	160,519	44,814	27,078	-	-	-	-	1,763,494	712,987
20 a 59.9 C-Medium	257,813	359,433	1,405	-	265,193	213,749	59,629	56,842	2,965	22,374	-	-	-	-	587,005	652,398
60 a 89.9 D-High	266,404	516,965	-	-	579,938	473,182	469,246	394,859	35,447	-	-	-	-	-	1,351,035	1,385,006
90 a 100 E-Irrecoverable	792,217	1,179,800	302	311	94,386	77,759	62,078	126,506	-	-	-	-	27,775	42,180	976,758	1,426,556
Additional reserves	-	-	-	-	-	-	598,549	2,152,047	-	-	-	-	1,236	-	599,785	2,152,047
Total	\$ 2,727,646	2,559,927	210,102	46,354	1,436,397	1,059,599	1,369,093	2,968,456	124,923	81,550	-	-	29,011	42,180	5,897,172	6,758,066

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The rated commercial loan includes the guarantees and irrevocable lines of credit granted by HSBC, which are recorded in memorandum accounts.

Unsecured loan:

On December 7, 2001 the IPAB, Atlántico and HSBC entered into an agreement (the Agreement) with the purpose of setting forth the terms and conditions for completing the financial reorganization of Atlántico in line with the provisions of transitory article nine of the Bank Savings Protection Law.

In the terms of the Agreement, Atlántico was obliged to invest in a instrument of payment issued by the IPAB, all resources received with the purpose to conclude the financial reorganization, as well as the promissory notes and credit rights Atlántico maintained and that were due by the IPAB.

On September 27, 2002, the Bank granted a \$47,356,995 (nominal) loan to the IPAB. The loan is documented by a promissory note that may only be endorsed to Banco de Mexico as a guarantee for the note amount. The loan matures on December 30, 2009 with the right of prepayment, and bears interest at a rate equal to the arithmetic average of the annual yield rates of 91-day Cetes sold during the interest accrual period plus one percentage point. Interest accrued on the loan is payable by the IPAB on the last day of each calendar quarter.

In November and December 2004, the IPAB prepaid principal of \$12,474,756 and \$2,686,639, respectively.

Loan swap:

HSBC and the Mexican financial authorities executed agreements to Exchange portfolio flows for promissory notes due by the FOBAPROA (currently the IPAB). The exchange agreements consider the delivery of cash flows from commercial loans in exchange for the cash flows of a promissory note, less a percentage of loan losses to be borne by HSBC.

At December 31, 2005 and 2004, the loan swap is analyzed as follows:

	<u>2005</u>	<u>2004</u>
Promissory notes	\$ 4,173,021	25,942,025
Loan collections, pending delivery to the IPAB	(43,254)	(300,578)
Allowance for uncollectible amounts	(3,033,622)	(7,384,780)
	\$ 1,096,145	18,256,667
	=====	=====

(Continued)

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During the third quarter of the 2005, the amount of the promissory notes was reduced by normal collection and because IPAB made anticipated and partial payments of \$6,691,547 (nominal) and \$4,561,722 (nominal) to the promissory notes of series N of Trust IPAB 187429 and 187437, respectively, and \$5,997,044 (nominal), to the Trust IPAB 187429 on its maturity.

Federal Government support programs:

As a result of the economic crisis in 1995, the Federal Government and the Mexican Bankers' Association established loan support programs and agreements so that debtors of credit institutions could comply with their obligations. The programs and agreements currently in effect are as follows:

- Financial Support and Promotion for Micro, Small and Medium-sized Companies (FOPYME).
- Financial Support to the Agricultural, Cattle-raising and Fishery Sector (FINAPE).
- Additional Benefits to Housing Loan Debtors (BADCV).
- Additional Benefits to FOVI Housing Loan Debtors (BADCVF).

The financial support programs and agreements consist of discounts granted to debtors, which are generally absorbed proportionately by the Federal Government and HSBC, in accordance with the terms of each program. Certain discounts are conditional subject to the net cash flows contributed by the HSBC to the specific economic sector. As of December 31, 2005 and 2004, receivables from the Federal Government in connection with discounts granted are as follows:

	<u>2005</u>	<u>2004</u>
Amount to receive:		
BADCV and BADCVF	\$ 371,431	420,381
FOPYME	1,833	3,414
FINAPE	<u>1,155</u>	<u>2,308</u>
	\$ 374,419	426,103
	=====	=====

The Financial Group's cost associated with the various debtor support programs and agreements for the years ended December 31, 2005 and 2004 is analyzed as follows:

	<u>2005</u>	<u>2004</u>
FOPYME	\$ 1,811	3,041
FINAPE	752	1,968
BADCV and BADCVF	<u>263,818</u>	<u>301,413</u>
	\$ 266,381	306,422
	=====	=====

(Continued)

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(b) *UDI Trust restructured loans-*

HSBC participated in several loan-restructuring programs established between the Federal Government and the Mexican banks. HSBC underwrote restructuring programs that consisted mainly of changing the peso-denominated loans to UDIs, through trusts created with funding provided by the Central Bank. At December 31, 2005 and 2004, the balances of restructured loans, accrued interest at annual average interest rates, that are analyzed as follows:

	2005			2004		
	Loan portfolio		Average annual interest rate	Loan portfolio		Average annual interest rate
	Current	Past due		Current	Past due	
Domestic productive plant	\$ -	-	-	1,279	-	7.11%
States and municipalities	-	-	-	394,545	-	7.58%
Residential mortgages	<u>3,877,645</u>	<u>520,403</u>	8.55%	<u>5,555,636</u>	<u>482,327</u>	8.72%
	<u>\$ 3,877,645</u>	<u>520,403</u>		<u>5,951,460</u>	<u>482,327</u>	

Some UDIS Trusts have matured or fulfilled their objective to eliminate totally their fiduciary liabilities.

(c) *Additional loan portfolio information-*

Annual weighted lending rates:

During 2005 and 2004, the annual weighted lending rates (unaudited) were as follows:

	<u>2005</u>	<u>2004</u>
Commercial loans	11.33%	9.56%
Financial entities	12.13%	10.85%
Personal loans	34.22%	32.76%
Residential mortgages	12.04%	14.33%
Government entities	11.69%	11.60%

(Continued)

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Loans rediscounted with recourse:

The Mexican Government has established certain funds to promote the development of specific areas of the agriculture, cattle-raising, industrial and tourism sectors, which are managed mainly by the Central Bank, Nacional Financiera, Banco Nacional de Comercio Exterior and Fondo de Garantía y Fomento para la Agricultura by rediscounting loans with recourse. At December 31, 2005 and 2004, the amount of loans granted under these programs aggregated \$7,449,675 and \$9,168,599, respectively, and the related liability is included in "Due to banks and other institutions".

Restructured loans:

At December 31, 2005 and 2004, restructured loans are analyzed as follows:

	<u>2005</u>			<u>2004</u>		
	<u>Loan portfolio</u>			<u>Loan portfolio</u>		
	<u>Current</u>	<u>Past due</u>	<u>Total</u>	<u>Current</u>	<u>Past due</u>	<u>Total</u>
Agriculture Portfolio Restructure Program System (SIRECA)	\$ 4,890	59,153	64,043	5,815	63,992	69,807
With Bank funds	<u>2,743,374</u>	<u>303,252</u>	<u>3,046,626</u>	<u>1,845,556</u>	<u>443,510</u>	<u>2,289,066</u>
	<u>\$ 2,748,264</u>	<u>362,405</u>	<u>3,110,669</u>	<u>1,851,371</u>	<u>507,502</u>	<u>2,358,873</u>

The amount of interest income recognized from the restructuring of past due loans aggregated \$416,352 and \$464,295, for the years ended December 31, 2005 and 2004, respectively. The Bank obtained additional guarantees when carrying out loan restructures.

Below is an analysis of the annual movement of past due loans for the years ended December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Balance at beginning of year	\$ 3,502,969	5,703,833
Collections	(3,100,321)	(2,690,438)
Write-offs	(1,331,719)	(2,012,689)
Transfers to current loan portfolio	(637,883)	(1,438,201)
Transfers from current to past due loan portfolio	5,159,603	4,560,131
Exchange rate fluctuations	(330)	88,315
Sale of loan portfolio	-	(305,355)
Other minor items	<u>(58,282)</u>	<u>(402,627)</u>
Balance at end of year	<u>\$ 3,534,037</u>	<u>3,502,969</u>

(Continued)

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The estimate of nominal interest that would have accrued in 2005 from the past due loan portfolio is \$336,029 (\$395,523 in 2004).

Impaired loans:

At December 31, 2005 and 2004, the balance of impaired commercial loans is \$1,535,728 and \$2,191,299, respectively, of which \$368,794 and \$565,952 are recorded as current loans and \$1,166,934 and \$1,644,900 as past due loans, respectively.

Risk concentration:

At December 31, 2005, HSBC's accounting records includes one loan which individually exceed the 10% of basic capital. The sum of the three largest credits amounted to \$5,457,210 (30.10% of basic capital).

At December 31, 2004, HSBC's accounting records includes three loans which individually exceeded 10% basic capital, in addition to being the three largest loans. The sum of these three credits amounted to \$5,625,554 (46.21% of basic capital).

(d) Allowance for loan losses-

As explained in notes 2h and 26c, an allowance is established to provide for credit risks associated with the collection of the Financial Group's loan portfolio.

At December 31, 2005 and 2004 the allowance for loan losses, analyzed in section (a) above is comprised as follows:

	<u>2005</u>	<u>2004</u>
Rated loan estimate	\$ 5,280,742	4,444,411
Additional reserves, including past due interest	<u>616,430</u>	<u>2,122,636</u>
	5,897,172	6,567,047
Inflation effect	<u>-</u>	<u>191,019</u>
Total allowance for loan losses	\$ 5,897,172 =====	6,758,066 =====

At December 31, 2005, the balance of the general (A) and specific (B-1 to E) allowance for loan losses amounts to \$1,218,880 and \$4,678,292, respectively (\$2,581,119 and \$4,176,947, respectively in 2004).

(Continued)

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The movement of the allowance for loan losses for the years ended December 31, 2005 and 2004 (in nominal pesos) is summarized below:

	<u>2005</u>	<u>2004</u>
Balance at beginning of year	\$ 6,567,047	8,028,088
Loan portfolio adquisition	-	140,871
Provisions charged to income*	1,159,571	1,129,475
Reinstatement of reserves	484,787	879,251
Exchange rate valuation effects	2,969	120,962
Applications:		
Write-offs	(1,497,380)	(3,039,297)
Debt forgiveness	(819,822)	(720,202)
Recoveries	<u>-</u>	<u>27,899</u>
	5,897,172	6,567,047
Restatement for inflation	<u>-</u>	<u>191,019</u>
Balance at end of year	\$ <u>5,897,172</u>	<u>6,758,066</u>

* Additionally, the expense for loan losses in the 2005 and 2004 in the consolidated statements of operations includes \$339,823 and \$207,333, respectively, for the loss sharing under the IPAB loan swap (see note 9a).

(10) Foreclosed assets or received in lieu of payment-

As of December 31, 2005 and 2004, foreclosed assets or assets received in lieu of payment are analyzed as follows:

	<u>2005</u>		<u>2004</u>	
	<u>Amount</u>	<u>Reserve</u>	<u>Amount</u>	<u>Reserve</u>
Securities and sundry assets:				
Sundry assets	\$ 50,225	(6,978)	114,412	(84,379)
Securities	<u>985,530</u>	<u>(946,826)</u>	<u>638,152</u>	<u>(612,037)</u>
	<u>1,035,755</u>	<u>(953,804)</u>	<u>752,564</u>	<u>(696,416)</u>
Premises:				
Land	252,612	(227,224)	360,676	(333,301)
Buildings	<u>970,647</u>	<u>(684,465)</u>	<u>1,396,014</u>	<u>(918,066)</u>
	<u>1,223,259</u>	<u>(911,689)</u>	<u>1,756,690</u>	<u>(1,251,367)</u>
	\$ 2,259,014	(1,865,493)	2,509,254	(1,947,783)
	<u>=====</u>	<u>=====</u>	<u>=====</u>	<u>=====</u>
	\$ 393,521		561,471	
	<u>=====</u>		<u>=====</u>	

(Continued)

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The reserve in 2005 amounted to \$52,286 (\$214,056 in 2004, which includes \$113,906 for the effect of adopting the new Dispositions).

(11) Premises, furniture and equipment-

Premises, furniture and equipment at December 31, 2005 and 2004 are analyzed as follows:

	<u>2005</u>	<u>2004</u>	<u>Annual depreciation rate</u>
Premises	\$ 3,133,753	2,319,846	Various
Office furniture and equipment	2,654,629	2,472,215	Various
Computer equipment	2,396,424	1,805,907	Various
Transportation equipment	132,909	123,765	Various
Installation expenses	2,187,688	1,812,737	10% and 5%
Other equipment	<u>838,268</u>	<u>719,909</u>	Various
	11,343,671	9,254,379	
Accumulated depreciation and amortization	<u>(6,870,745)</u>	<u>(5,883,671)</u>	
Land	4,472,926	3,370,708	
	<u>1,002,528</u>	<u>979,660</u>	
	<u>\$ 5,475,454</u>	<u>4,350,368</u>	

Depreciation and amortization charged to income in 2005 and 2004 amounted to \$849,667 and \$633,766, respectively.

(12) Permanent investments in shares-

At December 31, 2005 and 2004, permanent investments in shares of unconsolidated subsidiaries, associated and affiliated companies, classified by activity, are analyzed as follows:

	<u>2005</u>	<u>2004</u>
Unconsolidated subsidiaries:		
Insurance	\$ 1,427,965	1,355,678
Guarantee companies	231,457	236,095
Real estate companies	29,379	29,416
Associated and affiliated companies:		
Security and protection	1,832	10,139
Supplementary banking services	91,509	325,486
Statutory pensions funds	305,174	230,350
Mutual funds	14,419	53,548
Other activities	<u>143,221</u>	<u>65,800</u>
	<u>\$ 2,244,956</u>	<u>2,306,512</u>

(Continued)

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The equity in results of unconsolidated subsidiaries, associated and affiliated companies amounted to \$675,389 in 2005 (\$228,482 in 2004).

(13) Other assets, deferred charges and intangibles net-

At December 31, 2005 and 2004 other assets deferred charges and intangibles include:

	<u>2005</u>	<u>2004</u>
Recovering taxes	\$ 907,731	15,752
Labor obligations prepaid	505,764	532,361
Services and fess paid	50,268	237,412
Others	<u>219,223</u>	<u>141,738</u>
	\$ 1,682,986	927,263
	=====	=====
Goodwill:		
Bank	\$ -	13,480
Insurance	1,225,397	1,225,397
Afore	1,531,662	1,531,662
HSBC Panama	<u>696,490</u>	<u>593,203</u>
	3,453,549	3,363,742
Accumulated amortization	<u>(214,868)</u>	<u>(215,958)</u>
	\$ 3,238,681	3,147,784
	=====	=====

Acquisition of Grupo Financiero Finacomer, S. A. and Subsidiaries and HSBC Bank Panamá, S. A.-

On September 1, 2005 HSBC Bank (Panamá), S. A. acquired all the operations of Grupo Finacomer, S. A. and affiliated companies, which entailed acquiring assets, liabilities and stockholders' equity amounting to USD 40, USD 28 and USD 12 million, respectively. On July 31, 2004 the Group acquired from HSBC Bank USA 100% of the shares representing the capital stock of 15 branches, along with their respective assets and liabilities, that include 100% of the capital stock of Overseas Reality Corporation of Panamá, Panamá Realty Investment, S. A., HSBC Investment Corporation (Panamá), S. A. and HSBC Securities (Panamá), S. A., with assets, liabilities and stockholders' equity of USD 1,019, USD 895 and USD 124 million, respectively. For legal and statutory reasons, a new bank has been created from these companies, called HSBC Bank (Panamá), S. A.

Beginning January 1st 2005, an impairment of goodwill will be tested annually, according to the new bulletin C-15 of the Mexican GAAP.

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(14) Deposits funding-

The weighted average deposit rates (unaudited) during the years ended December 31, 2005 and 2004 are analyzed as follows:

	<u>2005 rates</u>			<u>2004 rates</u>		
	<u>Pesos</u>	<u>Dollars</u>	<u>UDIS</u>	<u>Pesos</u>	<u>Dollars</u>	<u>UDIS</u>
Demand deposits	0.67	0.49	-	1.05	0.41	-
Savings deposits	-	-	-	1.28	0.76	-
Time deposits	6.44	1.05	0.30	5.74	0.89	1.09
Money market	9.04	2.60	-	8.47	3.08	-
	====	====	=====	=====	====	====

The money market is comprised primarily of promissory notes denominated in pesos with interest payable at maturity and terms ranging from 1 to 365 days.

(15) Due to banks and other institutions-

At December 31, 2005 and 2004, due to banks and other institutions are analyzed as follows:

	<u>2005</u>		<u>2004</u>	
	<u>Term</u>		<u>Term</u>	
	<u>Short</u>	<u>Long</u>	<u>Short</u>	<u>Long</u>
Pesos:				
Banco de México	\$ -	-	270,169	-
Development banks*	1,037,124	170,994	1,873,008	264,106
Multiple banks	-	-	198,065	-
Promotion funds*	<u>3,021,151</u>	<u>1,848,651</u>	<u>3,329,431</u>	<u>1,933,453</u>
	\$ <u>4,058,275</u>	<u>2,019,645</u>	<u>5,670,673</u>	<u>2,197,559</u>
Foreign currencies:				
Development banks*	100,238	8,429	197,501	53,033
Promotion funds*	527,510	78,590	621,652	143,895
Foreign banks	<u>97,521</u>	<u>72,623</u>	<u>128,828</u>	<u>230,680</u>
	<u>725,269</u>	<u>159,642</u>	<u>947,981</u>	<u>427,608</u>
Total by term	<u>4,783,544</u>	<u>2,179,287</u>	<u>6,618,654</u>	<u>2,625,167</u>
Total due to banks and other institutions	\$ <u>6,962,831</u>	<u>9,243,821</u>	<u>9,243,821</u>	<u>9,243,821</u>
	=====	=====	=====	=====

* Secured by the loans granted under the respective schemes (see note 9c).

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At December 31, 2005 and 2004, the average annual rates (unaudited) are analyzed as follows:

	<u>Pesos</u>		<u>Foreign currency</u>	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Banco de México	-	7.06%	-	-
Development banks	10.25%	7.46%	5.91%	2.40%
Promotion funds	7.86%	5.88%	3.96%	2.60%
Foreign banks	-	-	-	1.59%
	=====	=====	=====	=====

(16) Securities lending-

At December 31, 2005, HSBC had entered into securities lending agreements, as borrower. These borrowings mature on January 2, 2006. The name, number and amount of the securities borrowed are described as follows:

<u>Securities</u>	<u>Number of securities</u>	<u>Total</u>
Bonos	40,840,000	\$ 4,172,632
Cetes	23,200,000	<u>216,132</u>
		\$ 4,388,764
		=====

(17) Pensions, seniority premiums, post-retirement benefits and compensation upon termination of labor relationship-

Beginning April 2004, the defined benefit pensions plan incorporates a defined contribution component, consequently the employees, in accordance with their age and service years, either remained in the existing scheme or transferred to the defined contribution scheme. The defined benefit pension plan (DBPP) includes all the union employees and employees whose retirement date is near; the rest of the employees elected the defined contribution pension plan (DCPP).

HSBC established a pension plan that all employees have the right to be included. As provided for by the collective bargaining agreement, all employees who reach 60 years old with 5 years of service or 55 years old with 35 years of service are eligible under the established non-contributory pension plan.

The plan also covers seniority premium benefits to employees that elected either the DBPP or DCPP, in accordance with the Federal Labor Law.

The cost, obligations and assets of the DBPP, seniority premiums and post-retirement medical benefits plans mentioned in note 2s were determined based on the calculations performed by an independent actuary.

(Continued)

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The effect of reduction or extinction due to the employees who took the option of the DCP, reduces the net periodic cost of the DBPP, in a similar amount to the annual contribution of the DCP.

The components of the net periodic cost for the years ended December 31, 2005 and 2004 are as follows (nominal pesos):

	<u>2005</u>		<u>2004</u>	
	<u>Pensions and seniority premiums</u>	<u>Medical benefits</u>	<u>Pensions and seniority premiums</u>	<u>Medical benefits</u>
Service cost	\$ 27,799	58,179	37,293	45,690
Interest cost	71,077	90,159	68,276	78,659
Return on plan assets	(84,594)	(61,887)	(87,081)	(48,234)
Actuarial (gain) loss	(538)	32,678	(1,066)	26,097
Amortization of plan modifications	5,549	56,843	5,504	54,039
Amortization of transition liability	4,631	15,913	4,570	15,128
Effect of reductions/ extinctions	(4,908)	-	(56,159)	-
Inflationary effect	<u>718</u>	<u>5,756</u>	<u>963</u>	<u>5,998</u>
Net periodic (benefit) cost	\$ 19,734 =====	197,641 =====	(27,700) =====	177,377 =====
			<u>2005</u>	<u>2004</u>
Net periodic (benefit) cost:				
Pension and seniority premium (DBPP)			\$ 19,894	(27,700)
Medical Benefits			201,479	177,377
Severance or disability			97,940	-
Period Contribution:				
Pensions (DCPP)			<u>69,743</u>	<u>40,000</u>
			\$ 389,056 =====	189,677 =====

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At December 31, 2005 and 2004, labor obligations are analyzed as follows:

	<u>2005</u>		<u>2004</u>	
	<u>Pensions and seniority premiums</u>	<u>Medical benefits</u>	<u>Pensions and seniority premiums</u>	<u>Medical benefits</u>
Projected benefit obligation (PBO)	\$ 1,539,013	1,902,971	1,378,036	1,692,109
Amortization pending items	(146,286)	(436,966)	(145,301)	(489,011)
Actuarial gain (loss)	<u>(92,918)</u>	<u>(854,603)</u>	<u>166,912</u>	<u>(655,027)</u>
Required assets	1,299,809	611,402	1,399,647	548,071
Loss: Plan assets	<u>1,308,805</u>	<u>1,136,175</u>	<u>1,457,734</u>	<u>881,671</u>
Net projected assets	\$ 8,996	524,773	58,087	333,600

Interest rates used in the actuarial projections are:

	<u>2005</u>	<u>2004</u>
Rate of return on plan assets	6.50%	6.50%
Discount rate	5.30%	5.25%
Salary increase rate	0.75%	1.50%
Estimated inflation rate	3.33%	3.50%

At December 31, 2005 the labor obligation for indemnity payments, are analyzed as follows:

PBO	\$ 319,399
Unamortized items:	
Transition assets	(241,549)
Unrecognized actuarial assets	<u>(43,832)</u>
Projected net liability	\$ 34,018

Projected net liability reconciliation:

Contributions	\$ 97,940
Payments	<u>(62,056)</u>
Total liabilities	35,884
Excess	<u>(1,866)</u>
	\$ 34,018

(Continued)

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(18) Outstanding subordinated debentures-

At December 31, 2005 and 2004, HSBC and HSBC Panamá had issued subordinated debentures, not convertible into shares of its capital stock. The debentures and accrued interest thereon are analyzed as follows:

	<u>2005</u>	<u>2004</u>
<i>Debentures placed:</i>		
In 2003, maturing in 2013 (HSBC)	\$ 2,200,000	2,263,993
Accrued interest	<u>6,856</u>	<u>6,875</u>
	2,206,856	2,270,868
In 2004, maturing in 2014 (HSBC Panamá)	<u>372,204</u>	<u>404,061</u>
Total de obligaciones subordinadas	\$ 2,579,060	2,674,929
	=====	=====

Debentures bear interest at a 28-day equivalent Equilibrium Interbank Interest Rate (TIIE). The Bank reserves the right to redeem the debentures beginning in May 2009.

The HSBC Panama debentures bear interest at three months Libor plus 65 basis points.

(19) Income (IT) and asset (AT) taxes and employee statutory profit sharing (ESPS)-

Under current Mexican tax law, corporations must pay the greater of their IT and AT. For determining taxable income for IT purposes there are specific rules relating to the deductibility of expenses and the recognition of the effects of inflation. ESPS is computed practically on the same basis as IT. During the year ended December 31, 2005 ESPS expense was \$415,557 (\$255,594 in 2004).

The AT Law provides for a 1.8% tax on restated assets, less certain liabilities. AT payable in excess of IT for the year may be recovered in the ten succeeding years, restated for inflation, provided that IT exceeds AT in any of such years.

At December 31, 2005 the IT and ESPS expense in the consolidated statement of operations is \$1,491,088.

During 2004, HSBC filed amendments to its income tax returns for the years 1999 to 2003. These amendments had the purpose of avoiding differences between the criteria used by HSBC in conformity with the Law and the comments received from the officers of the SHCP, related to the tax treatment of the IPAB swap operation (formerly Fobaproa). The amendment to the income tax returns was registered to consider the previous exclusion of all effects of the IPAB swap operations, which will be taxable or deductible at the liquidation date of the swap. This amendment reduced the tax losses by the amount of \$2,642,639. The issue mentioned in this paragraph did not trigger any penalties for HSBC.

In the next page is a reconciliation between the Bank's accounting income and taxable income for IT and ESPS purposes of HSBC.

(Continued)

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	<u>IT</u>	
	<u>2005</u>	<u>2004</u>
Income before IT, ESPS and equity in earnings of unconsolidated subsidiaries, associated and affiliated companies	\$ 6,984,143	5,644,334
(Loss) income before taxes of subsidiaries consolidated	(5,378)	(18,832)
Accounting effects of inflation, net	<u>(336,633)</u>	<u>326,781</u>
Income in nominal pesos	7,315,398	5,952,283
Add (deduct) reconciling items (in nominal pesos):		
Difference between accounting and tax depreciation	38,310	(25,609)
Net tax effects of inflation	149,364	292,031
Allowance for loan losses	(2,897,342)	(2,824,810)
Reserve for FOBAPROA promissory note and loss sharing	(4,095,694)	197,486
Write-offs	480,836	656,988
Nondeductible expenses	112,824	176,801
Provisions	(253,894)	(284,496)
Trust UDIS Banxico	(434,904)	(480,514)
Prepaid expenses	(361,788)	(261,431)
Non taxable recoveries	(81,488)	(526,613)
Special Cetes	643,519	-
Other, net	<u>(157,490)</u>	<u>(285,099)</u>
Taxable income before tax loss carryforwards	457,651	2,587,017
Amortization of prior years' tax loss carryforwards	<u>-</u>	<u>(448,032)</u>
Taxable income	\$ 457,651	2,138,985
IT expense at the rate 30% (33% in 2004)	\$ 137,295	705,865
ESPS expense at the 10%	415,577	248,370
IT prior years*	688,716	-
ESPS prior years	94,009	-
Excess of the provision	47,717	183,126
Inflation effect	<u>-</u>	<u>58,836</u>
IT and ESPS in the statement of operations	\$ 1,383,314	1,196,197

* During 2005, HSBC determined the fiscal effects of the UDIS Trusts that finished during previous exercises, which will appear in the complementary fiscal returns during 2006. This materialized a deferred IT of \$688,716. This also caused surcharges and updates of \$100,234 that were recognized in results operations.

(Continued)

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Deferred IT and ESPS:

The decrease in deferred taxes during 2005 comes from the recognition of the accumulated income of the UDIS Trust and the decrease during 2004, comprises the amortization of the tax loss carryforwards, the effect of special cetes Udis-Banxico, the loss sharing (see note 9a) and the valuation reserve. The items that give rise to significant portions of the deferred tax assets and liabilities at December 31, 2005 and 2004, in nominal pesos are presented below:

	<u>2005</u>	<u>2004</u>
Financial Group	\$ 40,570	44,915
HSBC México	617,833	2,199,368
HSBC Panamá	38,270	34,502
Others	<u>50,129</u>	<u>(4,176)</u>
	\$ 746,802	2,274,609
	=====	=====
	IT	
	<u>2005</u>	<u>2004</u>
Deferred tax assets:		
Allowance:		
For loan losses	\$ 978,061	1,545,579
For foreclosed assets	340,546	567,146
Others	162,114	-
Tax loss carryforwards	47,494	31,034
Loss-Sharing	833,136	2,086,424
Valuation reserve	-	(100,535)
ESPS provision	120,350	-
Other	<u>115,590</u>	<u>215,404</u>
	<u>2,597,291</u>	<u>4,345,052</u>
Deferred tax liabilities:		
Interest from Cetes UDIS-Banxico	(1,232,172)	(1,201,058)
Valuation of financial instruments	(291,930)	(30,549)
UDI Trusts	-	(657,463)
Advanced deductions	-	(140,000)
Prepaid expenses	(323,118)	(79,444)
Other	<u>(3,269)</u>	<u>(26,222)</u>
	<u>(1,850,489)</u>	<u>(2,134,736)</u>
Restatement for inflation	<u>-</u>	<u>64,293</u>
Net deferred tax assets	\$ 746,802	2,274,609
	=====	=====

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In assessing the realizability of deferred tax assets, the Financial Group's management considers the probability that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income, the performance of the loan portfolio and its allowance, and other factors. The Financial Group's management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

Deferred IT and ESPS changes for the years ended December 31, 2005 and 2004, in nominal pesos, are analyzed as follows:

	<u>2005</u>	<u>2004</u>
At beginning of year	\$ 2,274,609	3,560,899
Charged to operations:		
Deferred IT and ESPS expense	(1,346,079)	(1,269,443)
Reported in capital:		
Valuation effects of available-for-sale financial instruments	(160,376)	(3,200)
Other	(21,352)	(20,047)
	\$ 746,802	2,274,609
	=====	=====

Other considerations:

In accordance with the IT Law, tax loss carryforwards, restated for inflation, may be carried forward to offset the taxable income of the ten succeeding years. At December 31, 2004, HSBC amortized all tax losses. For the fiscal year 2005, the IT rate changes from 32% to 30%, and will further decrease by one percentage point every fiscal period, to 28% in 2007.

In accordance with Mexican tax law, the tax authorities are entitled to examine transactions carried out during the five years prior to the most recent income tax return filed.

In accordance with the Income Tax Law, companies carrying out transactions with related parties are subject to certain requirements as to the determination of prices, since such prices must be similar to those that would be used in arm's-length transactions.

Tax in Panama:

The IT rate for HSBC Panama is 30%.

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(20) Stockholders' equity-

The principal characteristics of stockholders' equity are described below:

(a) Structure of capital stock-

Activity in 2005

On April 21, 2005, the Ordinary General Stockholders' Meeting agreed to apply the net income of 2004 amounting to \$3,370,586 (\$3,275,315 nominal), against "statutory reserves" in the amount of \$168,529 (\$163,766 nominal), and the remaining \$3,202,057 (\$3,111,549 nominal) to "Other reserves", that will be available to the stockholders until Board of Directors agreed.

After the above activity, the capital stock of the Financial Group as at December 31, 2005 is comprised as follows:

- Fixed capital without right for withdrawal amounting to \$1,923,033 (nominal) represented by 961,516,572 Series "F" shares with a par value of two pesos each, which are fully subscribed and paid up.
- Authorized variable capital amounting to \$1,963,031 (nominal) represented by 981,515,567 Series "B" shares with a par value of two pesos each, which are fully subscribed and paid up.

Activity in 2004

On April 27, 2004, the Ordinary General Stockholders' Meeting agreed to apply the net income of 2003 amounting to \$1,645,688 (\$1,516,509 nominal), against "Statutory Reserves" in the amount of \$82,285 (\$75,825 nominal), and the remaining \$1,563,403 (\$1,440,684 nominal) to "Other reserves", that will be available to the stockholders until Board of Directors agreed.

After the above activity, the capital stock of the Financial Group as at December 31, 2004 is comprised as follows:

- Fixed capital without right for withdrawal amounting to \$1,919,527 (nominal) represented by 959,763,557 Series "F" shares with a par value of two pesos each, which are fully subscribed and paid up.
- Authorized variable capital amounting to \$1,966,537 (nominal) represented by 983,268,582 Series "B" shares with a par value of two pesos each, which are fully subscribed and paid up.

(b) Comprehensive income (loss)-

The comprehensive income (loss) reported in the consolidated statement of stockholders' equity represents the results of the Financial Group's activities during the year and includes the net income (loss), the gain or loss from valuing investments in "Available-for-sale" securities, permanent investment in shares and premises, furniture and equipment, and the translation effect of the foreign subsidiary and mandatory convertible subordinated debentures, which in accordance with the applicable accounting principles, are reported directly in stockholders' equity.

(Continued)

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(c) **Restrictions on stockholders' equity-**

The Financial Group segregates 5% of its net income for the year to the statutory reserves up to the amount of its paid-in capital stock.

Stockholder contributions may be reimbursed to the stockholders tax-free, to the extent that the tax basis of such contributions equal or exceed stockholders' equity. Retained earnings on which no income taxes have been paid, are subject to income taxes in the event of distribution to stockholders.

The unappropriated retained earnings of subsidiaries may not be distributed to the Bank's stockholders until these are received by way of dividends. Also, gains from marking to market investment securities and derivative transactions may not be distributed until realized.

(d) **Capitalization-**

The SHCP requires that credit institutions maintain a minimum capitalization percentage of risk-based assets, which is calculated by applying certain specific percentages according to the level of risk assigned. At December 31, 2005 and 2004 information relating to the Bank's net capital, risk-based assets and capital requirements (in millions of pesos) is as shown below:

<u>Basic, supplementary and net capital</u>	<u>2005</u>	<u>2004</u>
Stockholders' equity	\$ 19,324.3	13,343.8
Reduced by:		
Deferred taxes	(906.5)	-
Intangible assets	-	(1,096.2)
Investments in shares of financial entities	(195.6)	(16.3)
Investments in shares of other companies	(73.8)	(33.5)
Investment in subordinated debt	<u>(20.1)</u>	<u>(26.2)</u>
Basic capital (Tier 1)	18,128.3	12,171.6
Add:		
Subordinated debentures	2,200.0	2,264.0
General allowance for loan losses	<u>1,192.3</u>	<u>857.4</u>
Supplementary capital (Tier 2)	<u>3,392.3</u>	<u>3,121.4</u>
Net capital (Tier 1+ Tier 2)	\$ 21,520.6	15,293.0
	=====	=====

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Risk-based assets and capital requirements

	Equivalent risk-weighted assets		Capital requirements	
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>
Market risk:				
Transactions or positions:				
In pesos at nominal rates	\$ 40,544.6	30,175.0	3,243.6	2,414.0
In pesos at real rates or denominated in UDIS	1,582.0	1,277.6	126.6	102.2
In foreign currency at nominal rates	5,248.5	1,404.2	419.9	112.4
In UDIS or with returns linked to the Consumer Price Index	12.9	13.7	1.0	1.1
Foreign currency positions or with exchange rate indexed returns	1,039.4	3,247.9	83.1	259.8
Equities or with indexed returns	0.2	0.2	-	-
Total market risk	<u>48,427.6</u>	<u>36,118.6</u>	<u>3,874.2</u>	<u>2,889.5</u>
Credit risk:				
Group I (weighted at 0%)	-	-	-	-
Group II (weighted at 10%)	162.0	253.1	12.9	20.3
Group II (weighted at 11.5%)	-	-	-	-
Group II (weighted at 20%)	7,028.0	5,979.7	562.2	478.4
Group II (weighted at 23%)	599.9	1,094.8	48.0	87.6
Group III (weighted at 50%)	22.2	14.9	1.8	1.2
Group III (weighted at 100%)	90,767.1	64,117.2	7,261.4	5,129.4
Group III (weighted at 112%)	1,850.3	1,657.7	148.0	132.6
Group III (weighted at 115%)	451.8	-	36.1	-
Group III (weighted at 150%)	923.6	2,434.7	73.9	194.8
Total credit risk	<u>101,804.9</u>	<u>75,552.1</u>	<u>8,144.3</u>	<u>6,044.3</u>
Total market and credit risks	\$ <u>150,232.5</u>	<u>111,670.7</u>	<u>12,018.5</u>	<u>8,933.8</u>

	<u>2005</u>	<u>2004</u>
<u>Capitalization ratios:</u>		
Capital to credit risk assets:		
Basic capital (Tier 1)	17.81%	16.11%
Supplementary capital (Tier 2)	<u>3.33%</u>	<u>4.13%</u>
Net capital (Tier 1 + Tier 2)	21.14%	20.24%
	=====	=====
Capital to market and credit risk assets:		
Basic capital (Tier 1)	12.06%	10.90%
Supplementary capital (Tier 2)	<u>2.26%</u>	<u>2.80%</u>
Net capital (Tier1 + Tier 2)	14.32%	13.70%
	=====	=====

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(21) Related party transactions and balances-

During the normal course of business, the Financial Group carries out transactions with related parties. According to the Bank's policies, the Board of Directors authorizes all credit transactions with related parties, which are granted at market rates with guarantees and terms in accordance with sound banking practices. At December 31, 2005 and 2004, the Financial Group had granted loans to related parties totaling \$1,528,997 and \$550,876, respectively.

In addition to interest and commissions on the above-mentioned loans, the principal transactions carried out with related parties during the years ended December 31, 2005 and 2004, were as follows:

	<u>2005</u>	<u>2004</u>
<u>Transactions:</u>		
<u>Income:</u>		
Administrative services	\$ 332,234	228,265
Premium on securities purchased under agreements to resell	250,617	-
Other	<u>264,688</u>	<u>209,331</u>
	\$ <u>847,539</u>	<u>437,596</u>
<u>Expenses:</u>		
Insurance premiums	\$ -	290,719
Interest and commissions	-	1,143
Premiums on securities repurchase/resell agreements	254,838	156,589
Administrative expenses	110,299	2,701
Rents	-	4,607
Others	<u>-</u>	<u>2,057</u>
	\$ <u>365,137</u>	<u>457,816</u>

Balances receivable from and payable to related parties as of December 31, 2005 and 2004, were as follows:

	<u>2005</u>		<u>2004</u>	
	<u>Receivable</u>	<u>Payable</u>	<u>Receivable</u>	<u>Payable</u>
Mutual funds	\$ 18,306	-	11,885	-
HSBC Seguros, S. A. de C. V.	-	-	-	3,669
HSBC Vida, S. A. de C. V.	-	1,317	-	2,764
HSBC Casa de Bolsa, S. A. de C. V.	-	262	3,278	-
HSBC Fianzas, S. A.	-	7,495	8,215	11
HSBC Pensiones, S. A.	87	-	665	387
HSBC Operadora de Fondos, S. A. de C. V.	<u>254</u>	<u>-</u>	<u>-</u>	<u>-</u>
	\$ <u>18,647</u>	<u>9,074</u>	<u>24,043</u>	<u>6,831</u>

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(22) Memorandum accounts-**(a) Irrevocable lines of credit and guarantees-**

At December 31, 2005 and 2004, the Financial Group had irrevocable commitments to grant loans of \$3,761,174 and had issued guarantees of \$56,717 (\$2,256,557 and \$224,156, respectively, in 2004).

At December 31, 2005 the allowance for letters of credits and guarantees issued amounts to \$84,066 and \$28,610 in 2004, respectively, and is included in the allowance for loan losses.

(b) Assets in trust or under mandate-

The Financial Group's trust activity, which is recorded in memorandum accounts, is summarized as follows:

	<u>2005</u>	<u>2004</u>	
	<u>México</u>	<u>México</u>	<u>Panamá</u>
Type of trust:			
Administrative	\$ 34,383,728	29,329,280	64,012
Guarantee	10,169,460	12,259,744	-
Investment	11,224,919	12,463,282	1,964,904
Other	<u>10,691,974</u>	<u>9,221,914</u>	<u>140,179</u>
	66,470,081	63,274,220	2,169,095
Mandates	<u>298,587</u>	<u>331,238</u>	<u>-</u>
	\$ 66,768,668	63,605,458	2,169,095
	=====	=====	=====

Trust department revenue for the years ended December 31, 2005 and 2004 amounted to \$110,334 and \$112,864, respectively.

(c) Investments on behalf of customers-

The Financial Group receives funds from the public and invests them in various instruments of the Mexican financial system on behalf of its customers, which it records in memorandum accounts as follows:

	<u>2005</u>	<u>2004</u>
Mutual funds:		
Managed by HSBC	\$ 1,629,277	530,947
Other	868,976	946,940
Government securities	9,427,261	15,843,412
Equities and other	<u>4,940,022</u>	<u>8,302,890</u>
	\$ 16,865,536	25,624,189
	=====	=====

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The amount of funds invested in the Financial Group's own instruments forms part of the liabilities included in the consolidated balance sheet.

(d) Assets in custody-

The Financial Group records in this account the assets and securities of third parties it receives in custody or for management purposes. At December 31, 2005 and 2004, this account comprises:

	<u>2005</u>	<u>2004</u>
Assets in custody	\$ 14,433,706	8,332,836
Pledged assets	735,429	642,059
Assets under management	<u>41,768,110</u>	<u>41,591,624</u>
	\$ 56,937,245	50,566,519
		=====

(23) Additional information on results of operation and segments-

(a) Statement of operations by segment of HSBC-

The statement of operations by segment includes Personal Financial Services (**PFS**), Commercial Banking (**CMB**), Corporate, Investment Banking and Markets (**CIBM**) and other Corporate Activities (**OAC**). A brief description of the Bank's which comprises (which comprises the 98% of the Financial Group) business segments follows.

Personal Financial Services – Business segment focused primarily on individuals that comprises mainly consumer products, which include credit cards, personal and car loans as well as mortgage loans and traditional deposits.

Commercial Banking – Business segment focused primarily on corporations, offering financing in Mexican pesos and other currencies, lines of credit for working capital, term loans, and the financing of exports, in addition to financial services relating to checking and investment accounts and cash management.

Corporate, Investment Banking & Markets – This segment includes lines of products focused primarily on corporations, which comprise: trust, treasury and custody services, corporate finance advisory, as well as risk management and cash flow services. This segment comprises products such as letters of credit, factoring, discounted documents and investments in the money and capital markets.

Other Corporate Activities – This segment includes transactions not conducted directly or indirectly with the customers, it represents structural business operations.

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Notes to Consolidated Financial Statements

December 31, 2005 and 2004

(Million of Mexican pesos of constant purchasing power as of December 31, 2005)

	Banking								Total	
	PFS		CMB		CIBM		OAC		2005	2004
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Financial margin	\$ 8,658.0	7,017.6	2,577.4	1,840.4	1,763.1	431.2	1,620.6	2,370.8	14,619.1	11,660.0
Allowance for loan losses	<u>(35.6)</u>	<u>(317.6)</u>	<u>(5.9)</u>	<u>(82.3)</u>	<u>(0.3)</u>	<u>(9.6)</u>	<u>(1,447.2)</u>	<u>(953.1)</u>	<u>(1,489.0)</u>	<u>(1,362.6)</u>
Adjusted financial margin	8,622.4	6,700.0	2,571.5	1,758.1	1,762.8	421.6	173.4	1,417.7	13,130.1	10,297.4
Commissions and fees, net	4,547.9	4,500.7	1,461.9	1,179.3	414.5	429.0	260.4	298.3	6,684.7	6,407.3
Financial intermediation income	<u>328.0</u>	<u>339.9</u>	<u>74.8</u>	<u>89.1</u>	<u>980.6</u>	<u>336.0</u>	<u>(27.7)</u>	<u>141.1</u>	<u>1,355.7</u>	<u>906.1</u>
Total operating income	13,498.3	11,540.6	4,108.2	3,026.5	3,157.9	1,186.6	406.1	1,857.1	21,170.5	17,610.8
Administrative and promotion expenses	<u>(11,200.7)</u>	<u>(9,363.6)</u>	<u>(2,365.1)</u>	<u>(1,842.6)</u>	<u>(1,169.9)</u>	<u>(780.8)</u>	<u>37.9</u>	<u>(244.6)</u>	<u>(14,697.8)</u>	<u>(12,231.6)</u>
Net operating income (loss)	2,297.6	2,177.0	1,743.1	1,183.9	1,988.0	405.8	444.0	1,612.5	6,472.7	5,379.2
Other income, net	-	50.6	-	32.2	-	10.9	511.4	171.4	511.4	265.1
Taxes	<u>(884.8)</u>	<u>(935.2)</u>	<u>(671.2)</u>	<u>(510.8)</u>	<u>(765.5)</u>	<u>(175.0)</u>	<u>(402.9)</u>	<u>(839.7)</u>	<u>(2,724.4)</u>	<u>(2,460.7)</u>
Income (loss) before equity in results of subsidiaries	1,412.8	1,292.4	1,071.9	705.3	1,222.5	241.7	552.5	944.2	4,259.7	3,183.6
Equity in results of subsidiaries	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>15.8</u>	<u>13.5</u>	<u>15.8</u>	<u>13.5</u>
Income of continuing operations	1,412.8	1,292.4	1,071.9	705.3	1,222.5	241.7	568.3	957.7	4,275.5	3,197.1
Result of discontinued transactions	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(76.0)</u>	<u>(7.1)</u>	<u>(76.0)</u>	<u>(7.1)</u>
Net income (loss)	\$ <u>1,412.8</u>	<u>1,292.4</u>	<u>1,071.9</u>	<u>705.3</u>	<u>1,222.5</u>	<u>241.7</u>	<u>492.3</u>	<u>950.6</u>	<u>4,199.5</u>	<u>3,190.0</u>

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At December 31, 2005 and 2004, the following items comprise the financial margin:

	<u>2005</u>	<u>2004</u>
<i><u>Interest income:</u></i>		
Cash and equivalents	\$ 2,689,824	1,521,097
Investment securities	3,955,834	2,155,458
Interest and premiums on securities purchased under agreements to resell	4,030,745	3,157,617
Loan portfolio:		
Comercial loans	4,150,303	3,345,950
Financial Institutions	412,600	222,876
Consumer loans	3,937,709	2,090,716
Residential mortgages	1,786,164	1,226,399
Government entities	2,462,837	394,281
IPAB	2,467,349	4,597,868
Other including inflation effect	<u>456,707</u>	<u>681,316</u>
	26,350,072	19,393,578
Interest expense:		
Deposit funding	(729,637)	(633,207)
Time deposit	(4,705,571)	(2,440,414)
Due to banks and other institutions	(948,358)	(496,539)
Interest and premiums on securities purchased under agreements to resell	(3,883,536)	(3,159,688)
Interest by subordinated debentures outstanding	(215,570)	(162,337)
Others including inflation effect	<u>(353,814)</u>	<u>(305,717)</u>
	(10,836,486)	(7,197,902)
Monetary position result associated to financial margin	<u>(320,331)</u>	<u>(350,544)</u>
	\$ 15,193,255	11,845,132
	=====	=====

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The average balance (in nominal pesos) of the principal monetary asset and liability captions used in determining the net monetary position of HSBC from non-financial margin items is shown below:

	<u>2005</u>		<u>2004</u>	
	<u>Financial</u>	<u>Others</u>	<u>Financial</u>	<u>Others</u>
	<u>margin</u>		<u>margin</u>	
Assets:				
Cash and equivalents	\$ 44,030,089	-	39,637,462	-
Investment securities	48,298,407	75,682	29,871,901	107,094
Derivative financial instruments	553,463	-	71,095	-
Loan portfolio	118,677,565	-	121,893,427	-
Other accounts receivable	-	9,819,260	-	8,951,704
Foreclosed assets	-	281,921	-	574,776
Deferred income tax	-	2,593,315	-	3,492,967
Permanet investments in shares	-	14,937	-	18,360
Others	-	437,400	-	465,766
	<u>211,559,524</u>	<u>13,222,515</u>	<u>191,473,885</u>	<u>13,610,667</u>
Monetary position asset average				
Liabilities:				
Deposits	(186,595,869)	-	(172,579,513)	-
Due to banks and other institutions	(12,051,836)	-	(11,628,021)	-
Derivative financial instruments	(2,536,603)	-	19,721	-
Subordinated debentures outstanding	(2,342,916)	-	(2,511,512)	-
Others account payable	-	(11,499,967)	-	(9,449,061)
Deferred credits	-	(1,566,923)	-	(1,188,272)
	<u>(203,527,224)</u>	<u>(13,066,890)</u>	<u>(186,699,325)</u>	<u>(10,637,333)</u>
Monetary position liability average				
Monetary position average, net	8,032,300	155,625	4,774,560	2,973,334
	=====	=====	=====	=====
Monetary position result	\$ (241,348)	(4,526)	(272,256)	(162,058)
	=====	=====	=====	=====

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(b) **Financial intermediation gain (loss)-**

For the years ended December 31, 2005 and 2004, the financial intermediation gain (loss) is analyzed as follows:

	<u>2005</u>	<u>2004</u>
<i>Valuation gain (loss):</i>		
Investment securities	\$ (2,514)	4,395
Securities repurchase/resell agreements	37,527	(8,141)
Trading derivatives	239,768	65,172
Foreign currency exchange and precious metals	<u>(5,012)</u>	<u>(3,717)</u>
	<u>269,769</u>	<u>57,709</u>
<i>Purchase/sale gain (loss):</i>		
Investment securities	(73,572)	242,816
Securities repurchase/resell agreements	290,159	26,920
Foreign currency exchange and precious metals	<u>865,891</u>	<u>559,633</u>
	1,082,478	829,369
Restatement for inflation	<u>11,187</u>	<u>25,803</u>
	\$ 1,363,434	912,881
	=====	=====

(c) **Other income-**

For the years ended December 31, 2005 and 2004, other income is analyzed as follows:

	<u>2005</u>	<u>2004</u>
Recoveries	\$ 856,687	796,137
Gain on sale of foreclosed assets or received in lieu of payment	211,408	300,499
Gain on sale of premises, furniture and equipment	2,289	34,486
Other, including restatement for inflation	<u>424,211</u>	<u>31,924</u>
	\$ 1,494,595	1,363,046
	=====	=====

(Continued)

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(d) Other expense-

At December 31, 2005 and 2004, other expense includes:

	<u>2005</u>	<u>2004</u>
Write-offs and losses	\$ 905,686	899,482
Monetary position loss from non-financial margin items	4,526	162,058
Other, including restatement for inflation	<u>110,709</u>	<u>14,812</u>
	\$ 1,020,921	1,076,352
	=====	=====

(e) Financial indicators-

The principal financial indicators of HSBC as of and for the years ended December 31, 2005 and 2004 are analyzed below:

	<u>2005</u>	<u>2004</u>
Non-performing loans to total loans	2.7%	3.0%
Allowance for loan losses to past-due loan portfolio	167.9%	195.2%
Operating efficiency (<i>administrative and promotional expenses to average total assets</i>)	6.6%	6.7%
ROE (<i>net income to average stockholders' equity</i>)	27.9%	23.9%
ROA (<i>net income to average total assets</i>)	2.0%	1.5%
Liquidity (<i>liquid assets/liquid liabilities</i>)*	83.0%	73.6%
Financial margin after provision for loan losses /average earnie assets	5.9%	5.8%
Capital to credit risk assets	21.1%	20.2%
Capital to market and credit risk	14.3%	13.7%

* *Liquid assets* – Cash and equivalents, trading and available-for-sale securities.

* *Liquid liabilities* – Demand deposits, demand and short-term bank and other loans.

(f) Extraordinary item-

In May 2005, IPAB concluded the audit that fulfills the fifth article requirements of the Bank Saving Protection Law, during the period from January 2001 to march 2004, regarding the management, legality and legitimacy of HSBC's loan portfolio that was part of the Capitalization Program and Purchase Porfolio ("the Program"). As a result of the audit the IPAB regarded some loans as replicated and asked the accrued interest to be cancelled (loans with no stock reported in the Program). The Bank recognized a loss of \$76,037 which it recorded under "Discontinued operations, extraordinary items and changes in accounting policies" in the consolidated statement of operations.

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On July 13, 2004, the Bank exchanged the Fobaproa promissory note for new payment instruments issued by the IPAB. The amount exchanged excluded \$7,072 for the updated amount of loans that the IPAB regarded as related loans and formed part of the Capitalization and Portfolio Purchase Program. Consequently, the Bank as trustee recognized a loss for this amount, which it recorded under "Discontinued operations, extraordinary items and changes in accounting policies" in the consolidated statement of operations.

(24) Commitments and contingent liabilities-

(a) Leases-

Certain premises and equipment are leased from its related companies. Lease agreements provide for regular adjustments to rent amounts based on changing economic factors. Total lease expense aggregated \$842,137 in 2005 and \$590,960 in 2004.

(b) Lawsuits and litigation-

The Financial Group is involved in a number of lawsuits and claims arising in the normal course of business. It is not expected that the final outcome of these matters will have a significant adverse effect on the Financial Group's financial position and results of operations. Certain cases are covered by an indemnity clause of the agreement with the IPAB, the Bank and Atlántico dated December 7, 2001.

(c) Labor obligations-

Those arising from the obligations mentioned in the last paragraph of note 2s.

(d) Sole accountability agreement-

The Financial Group subscribed an agreement with its subsidiaries, whereby it undertakes several and unlimited responsibility for complying with the obligations of the financial entities comprising the Financial Group, relating to activities that based on the applicable provisions, correspond to each of them. In addition, the Financial Group has unlimited responsibility for the losses of each and every one of such entities.

(25) Recently issued accounting standards-

Beginning January 1, 2006, financial statements prepared in accordance with Mexican GAAP must be prepared in conformity with Financial Reporting Standards, which update and comprise the accounting standards in Mexico. Through May 2004, the Accounting Principles Commission (Comisión de Principios de Contabilidad or CPC) of the IMCP was in charge of issuing said standards contained in the Bulletins of Mexican GAAP (Bulletins), which are deemed standards, and in the Circulars, which are regarded as opinions or interpretations.

Beginning June 1, 2004, the aforementioned function was transferred to the Mexican Board for Research and Development of Financial Reporting Standards (Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera or CINIF). CINIF is an entity whose objectives are to develop Financial Reporting Standards (FRS) in Mexico, that are useful to both issuers and users of financial information, as well as to achieve as much consistency as possible with the International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board.

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Through December 2005, CINIF has issued eight series A and one series B Financial Reporting Standards. Therefore, Mexican FRS currently include both the standards issued by CINIF and the Bulletins and Circulars issued by CPC, that have not been revised, substituted or superseded by the new FRS.

The principal changes included in the aforementioned FRS, which are effective for fiscal years beginning after December 31, 2005, are the following:

- (a) Donations received are included in the results of operations, instead of in contributed capital.
- (b) Elimination of special and extraordinary items, classifying income statement items as ordinary and non-ordinary.
- (c) Retroactive recognition of the effects of changes in particular standards.
- (d) Disclosure of the authorized date for issuance of financial statements, as well as the officer or body authorizing issuance.

The structure of the financial statements would not be modified had the foregoing changes been effective as of December 31, 2005 due to the supplementary process.

(26) Risk management-

In conformity with the Banking Commission's regulatory requirements on disclosure of policies and procedures established by credit institutions for comprehensive risk management, below are the measures implemented by management for that purpose, as well as the relevant quantitative information.

Compliance with Circular "Prudential Provisions on Comprehensive Risk Management" issued by the Banking Commission is effected by recognizing fundamental principles for efficient and effective risk management, evaluating the environment of for both quantifiable (credit, market and liquidity) risks and non-quantifiable (operational and legal) risks, and under the view that the basic identification, measurement, monitoring, limitation, control and dissemination processes are performed.

Market Risk

Qualitative information

Description of qualitative issues related to the Comprehensive Risk Management process

The objective of the Financial Group's market risk management function is to identify, measure, monitor, limit, control, inform and disclose the various risks to which the institution is exposed.

The Board of Directors establishes the Risk Committee, whose objective is to manage the risks to which the institution is exposed, and to oversee that transactions adhere to the risk management purposes, policies and procedures and the global and specific risk exposure limits previously approved by the Board of Directors.

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Market risk, as defined by the institution, is the “risk that market prices and rates on which the Financial Group has taken positions – interest rates, foreign exchange rates, stock prices, etc. – move adversely relative to positions taken, thus causing losses to the Financial Group; that is, the potential loss arising from changes in risk factors relating to the valuation or expected results of assets, liabilities or contingent liability transactions, such as interest rates, foreign exchange rates, price indexes, among others.

The principal market risks to which the Financial Group is exposed, based on its portfolio exposure to changes in the various risk factors, are generally classified as follows:

- **Foreign exchange or foreign currency risk**
- **Interest rate risk**
- **Stock-related risk**
- **Volatility risk**
- **Base or margin risk**

Principal elements of market risk management methodologies

The Financial Group measures elected to identify and quantify the Market Risk exposure are Value at Risk (VaR) and “Present Value of a Basis Point” (PVBP) calculations, which measure the sensitivity to interest rates. Both risk measures are monitored on a daily basis compared to market risk exposure limits duly approved by Management. Additionally, stress testing is performed. Furthermore, it is important to mention that to calculate VaR and PVBP, all of the Financial Group’s positions are marked to market.

Value at Risk (VaR)

The VaR is the statistical measure of a portfolio’s maximum potential loss arising from changes in market risk factors of the financial instruments for a given holding period. Therefore, the VaR calculation is based on specific levels of confidence and holding periods. The VaR is arrived at by using the Monte Carlo simulation method, which estimates the potential losses resulting from movements in all market risk factors. The Board of Directors, at the Risk Committee’s proposal, has set a confidence level of 99% with a 1-day holding period; accordingly, the VaR level represents the maximum loss that the Financial Group could possible experience in one day with a 99% probability.

Present Value of a Basis Point (PVBP) and Forward PVBP (F-PVBP)

The PVBP is a technique to measure the market risk exposure resulting from changes in interest rates. This measure shows the potential loss that results from a one basis point change in interest rates used to determine the price of financial assets and liabilities, marking to market all of the positions in financial instruments sensitive to interest rates.

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The purpose of the Forward PVBP (F-PVBP) is to measure the effect of interest rate changes on financial instruments subject to interest rates. In this sense, the F-PVBP is based on the assumption of a scenario in which the forward rates implied in the curve increase by one basis point.

Stress testing

This is a technique that takes into consideration extreme values occurring isolatedly but which are unlikely based on the distribution of probabilities assumed for the market risk factors. The generation of stress testing scenarios for analyzing the sensitivity of the Financial Group's positions and the interest rate risk exposure is performed on the basis of hypothetical scenarios. Both positive and negative changes are considered to measure the impact on the portfolios of the Financial Group.

Methods for Validation and Calibration of Market Risk models

In order to detect in a timely manner any decrease in the prediction quality of the model, automatic data loading systems are in place, thus preventing manual data inputting. Furthermore, for the purpose of measuring the efficiency of the VaR estimation model, back-testing is performed. This type of test allows verification that the maximum estimated losses, on average, do not exceed the reliability level established, comparing the profits/losses that would have been generated had the portfolio been held during the VaR holding period. Back-testing is reinforced by performing hypothesis testing procedures.

As for the PVBP, it has been compared with the sensitivity of the portfolios to market quotations. The results of these tests confirm the accuracy of the models. In order to reinforce the validation and verification of the various risk factors, a set of matrices has been designed that show the behavior of different risk factors selected in order to check their reasonableness in relation to the values prevailing in the financial markets and verify the current value and the value on the preceding business day for consistency.

Portfolios subject to VaR and PVBP calculation

The market risk area calculates the VaR and PVBP for the Financial Group's total portfolio and specific Accrual and Trading portfolios so as to monitor the Financial Group's own and trading positions.

Global VaR is estimated for each portfolio. Additionally, VaR is broken down by risk factors (Interest Rates and Foreign Exchange Rates). PVBP is broken down by type of rate (pesos, dollars and UDIS – Real Rate), and Forward PVBP is presented by segment of the forward curve (Buckets), for both peso and dollar interest rates.

Stress testing is performed for the Financial Group's portfolio and the Trading and Accrual portfolios. Furthermore, a special stress test is performed for Available for Sale and Hedging Securities.

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Quantitative information

The Bank's VaR and PVBP and the Trading and Accrual portfolio sub-division for the 4Q of 2005 (in million of dollars) are as follows:

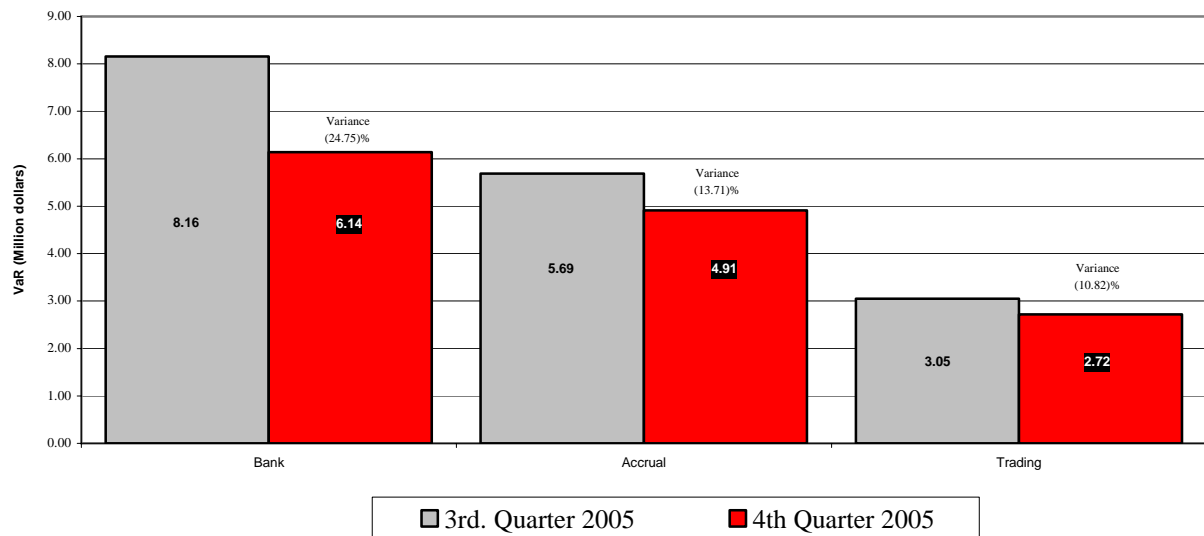
Value at Risk (VaR) (All risk factors being considered)

	2005				
	September 30	December 31	Limits *	3 rd quarter average	4 th quarter average
Bank	(8.07)	(6.17)	30.000	(8.16)	(6.14)
Accrual	(4.76)	(5.78)	27.500	(5.69)	(4.91)
Trading	(4.32)	(3.05)	13.500	(3.05)	(2.72)
Money market trading	(2.82)	(1.45)	7.500	(2.42)	(1.65)
Foreign exchange desk	(0.02)	(0.35)	13.500	(0.10)	(0.69)
Money market desk	(1.64)	(2.30)	13.500	(0.95)	(1.49)

* Absolute value

The Bank's VaR at the end of 4Q of 2005 decreased by 23.54% as compared to the 3Q. During the period the VaR levels remained below the total limits set by Management.

AVERAGE VAR* COMPARISON



* Figures in millions of dollars (absolute value)

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The Bank's average VaR for the 4Q of 2005 varied by 24.51% vs. 3Q. During the period the VaR levels remained below the total limits set by Management.

VaR vs. Net Capital Comparison

Below is a comparative VaR vs. Net Capital table for the last two quarters of 2005, in millions of dollars.

	<u>Third quarter</u>	<u>Fourth quarter</u>
Total VaR *	8.16	6.14
Net Capital **	1,658	2,024
VaR / Net Capital	0.49%	0.30%

* Quarterly Average VaR of the Bank (absolute value)

** Net Capital of the Bank at the end of quarter

Net capital for the 4Q of 2005 varied by 22.04% as compared to the end of 3Q. Average VaR represented 0.30% of net capital in 4Q and 0.49% in 3Q of 2005 (a variance of 19 basis points).

Present Value of a Basis Point (PVBP) for Peso Interest Rates

	2005				
	<u>September 30</u>	<u>December 31</u>	<u>Limits *</u>	<u>3rd- Quarter average</u>	<u>4th Quarter average</u>
Bank	(0.508)	(0.503)	0.550	(0.432)	(0.381)
Accrual	(0.368)	(0.360)	0.600	(0.350)	(0.294)
Trading	(0.140)	(0.144)	0.200	(0.082)	(0.087)
Money market desk	(0.140)	(0.144)	0.200	(0.082)	(0.087)

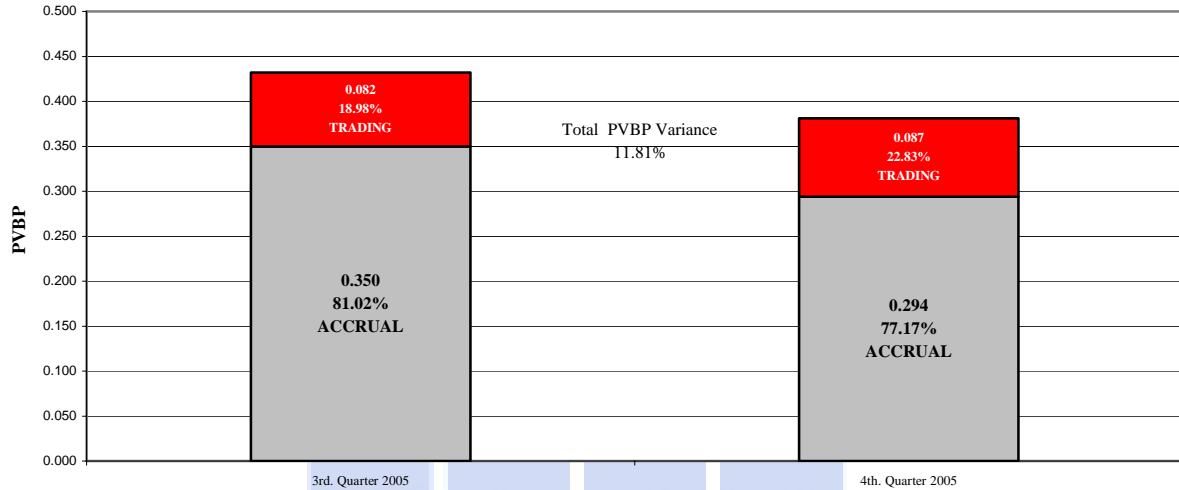
* Absolute value

The Bank's PVBP at the end of the 4Q of 2005 declined by 0.98% as compared to the 3Q. During the period the PVBP levels remained below the total limits set by Management.

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AVERAGE PVBP* COMPARISON



* Figures in millions of dollars (absolute value)

The Bank's average PVBP for the 4Q of 2005 varied by 11.81% as compared to the 3Q. During the period the PVBP levels remained below the total limits set by Management.

Liquidity risk

Beginning September 2005, the Financial Group improved the liquidity risk analysis by complementing the calculation of liquidity ratios with cash flow projections. Cash flow projections improve the analysis by presenting a dynamic view of the balance sheet and include elements that are not factored into the analysis of liquidity ratios.

The cash flow analysis is performed by projecting operating cash flows (interest income, commissions and brokerage fees, and administrative costs net of depreciation). Cash flows generated by balance sheet changes arising from an increase in business volume and current maturities are added to the operating cash flows. Furthermore, for this analysis it is assumed that the Treasury investment portfolio may serve to mitigate those situations where the Financial Group's liquidity is at risk.

Cash flows are subjected to three scenarios where the Bank's liquidity might be at risk, considering different potential levels of deposit withdrawals and restrictions in terms of funding capability. It is important to mention that the Bank's liquidity level is appropriate under any such scenarios.

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Cash flow projection scenarios (thousands of dollars)

<u>Scenario 1</u>	<u>Up to 7 days</u>	<u>7 days to 1 month</u>	<u>1 – 3 months</u>	<u>3 – 6 months</u>	<u>6 – 9 months</u>	<u>9 – 12 months</u>
Total cash inflows	10,170,446	4,787,704	4,191,922	3,672,282	888,394	5,423,489
Total (cash outflows)	<u>(5,413,487)</u>	<u>(4,537,550)</u>	<u>(6,166,930)</u>	<u>(3,259,119)</u>	<u>(2,933,095)</u>	<u>(2,086,322)</u>
Net cash flow	<u>4,756,959</u>	<u>250,154</u>	<u>(1,975,008)</u>	<u>413,163</u>	<u>(2,044,701)</u>	<u>3,337,167</u>
Cumulative cash flows	4,756,959 =====	5,007,113 =====	3,032,105 =====	3,445,268 =====	1,400,567 =====	4,737,734 =====
 <u>Scenario 2</u>						
Total cash inflows	10,170,044	4,787,704	4,191,922	3,672,282	888,394	5,423,489
Total (cash outflows)	<u>(5,684,558)</u>	<u>(5,492,726)</u>	<u>(6,853,621)</u>	<u>(3,267,909)</u>	<u>(2,953,313)</u>	<u>(2,086,322)</u>
Net cash flow	<u>4,485,486</u>	<u>(705,022)</u>	<u>(2,661,699)</u>	<u>404,373</u>	<u>(2,064,919)</u>	<u>3,337,167</u>
Cumulative cash flows	8,122,082 =====	3,780,866 =====	1,119,167 =====	1,523,540 =====	(541,379) =====	2,795,788 =====
 <u>Scenario 3</u>						
Total cash inflows	11,771,044	4,672,138	4,170,733	3,672,282	888,394	5,423,489
Total (cash outflows)	<u>(3,648,961)</u>	<u>(3,680,399)</u>	<u>(5,911,896)</u>	<u>(3,088,613)</u>	<u>(2,796,251)</u>	<u>(1,990,030)</u>
Net cash flow	<u>8,122,083</u>	<u>991,739</u>	<u>(1,741,163)</u>	<u>583,669</u>	<u>(1,907,857)</u>	<u>3,433,459</u>
Cumulative cash flows	8,122,083 =====	9,113,822 =====	7,372,659 =====	7,956,328 =====	6,048,471 =====	9,481,930 =====
 <u>Base scenario</u>						
Total cash inflows	10,170,446	4,797,108	4,314,167	4,333,344	1,494,917	6,876,322
Total (cash outflows)	<u>(5,006,880)</u>	<u>(3,854,081)</u>	<u>(6,433,975)</u>	<u>(3,644,732)</u>	<u>(3,346,728)</u>	<u>(2,881,101)</u>
Net cash flow	<u>5,163,566</u>	<u>943,027</u>	<u>(2,119,808)</u>	<u>688,612</u>	<u>(1,851,811)</u>	<u>3,995,221</u>
Cumulative cash flows	5,163,566 =====	6,106,593 =====	3,986,785 =====	4,675,397 =====	2,823,586 =====	6,818,807 =====

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Credit risk

Transactions with customers originate credit risk exposure. This exposure is recorded in the balance sheet as memorandum accounts. Exposure to credit risk recorded in the balance sheet includes items representing loans, while that recorded in memorandum accounts represents a contingent risk to the Bank.

The Financial Group has developed policies and procedures to manage its loan portfolio risk level and composition, with the purpose of quantifying and managing the loan portfolio-related credit risks and reducing the risk of loss resulting from a customer's failure to comply with the terms of the loan agreement. To this end, the Financial Group uses models typified as noncompliance models. Under this approach, the credit risk should be understood as the risk of non-payment and irrecoverability of loans granted or to be granted to a certain customer and in financial instrument transactions where counterparties may default. The risk of non-payment refers to the likelihood that a given customer may default on its commitments to pay both the principal and interest thereon, while the risk of irrecoverability refers to the likelihood that in the future the Bank will be unable to recover the funds loaned to a customer plus incidental charges.

Policies and procedures have been implemented for granting, controlling and collecting loans, as well as evaluating and monitoring credit risk and the methods used to identify current or past-due impaired commercial loans.

The aforementioned proposals are analyzed and authorized by the Executive Direction for Loan Analysis and Approval, or referred to the appropriate resolution level for ensuring adequate segregation of business origination and credit authorization activities.

The authorization of all loans is the responsibility of the Financial Group's Board of Directors. This power has been delegated to certain officers of the Institution. Each officer's authorization level is assigned depending on the officer's level, experience and skills at the Financial Group. Currently, this power has been granted to executives from the Credit and Risk area and to the General Direction.

In order to properly follow-up on the general portfolio, it is a Financial Group's policy to perform a loan study of all customers at least once a year and of impaired customers once every six months. Also, for proper monitoring those studies undergo normal evaluation and authorization processes applied to new and reassessed loans.

The account executive in charge is responsible for the complete relationship with the customer throughout the credit process, from origination through to total recovery of the loan. For this purpose, the account executive has tools and support such as portfolio control systems, authorized line records and the systems to follow-up on legal actions, among other things. There are supporting areas for the recovery of special portfolio, which as in the case of impaired portfolio management, follow specific policies in this regard.

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Among the loan procedures, there are actions for the early detection of impaired loans. These actions include, among other things, modification in risk levels between one quarter and another, negative signals resulting from inspection visits to customer's premises, negative reports in the Credit Bureau or adverse changes in the customers' economic environment. Once the increase in risk has been detected, monitoring procedures are established, which include the transfer of these accounts to special recovery areas.

Credit risk concentration- the Financial Group has policies and procedures in place to maintain a sound, diversified and risk-controlled and prudent portfolio, which include the establishment of credit risk exposure limits, considering business units, currency, etc.

The evaluation of credit customers during the origination process for consumer or mortgage loans is performed by utilizing parametrical models that assess both the customer's profile and the credit repayment history in the Credit Bureau. Acceptance of prospective credit customers is determined on the basis of the customer's grade points obtained in the evaluation. Customers rated below a given level are rejected. Customers who are less likely to default are rated higher by the models.

The efficiency of the origination models is evaluated on a quarterly basis, verifying that the population being evaluated by the model is similar to that on which the model was devised, the model continues being capable of distinguishing credit worthy customers from non-credit worthy customers, and customers representing a lower risk are still rated higher by the system. The model is recalibrated or replaced when any deviation in the model efficiency is detected.

Consumer and mortgage loan portfolio management includes preparing monthly reports to measure the credit quality of the loan portfolio. The reports are segmented by each product in the portfolio. This credit quality measures include, among other things, general statistics of the portfolio, distribution measures by delinquency level, delinquency measures by opening date and delinquency level transition reports. Furthermore, the estimated loan loss is determined on a monthly basis. The estimated loan loss model currently used by the Financial Group applies a bidimensional approach under which a default probability and a loss seriousness percentage are assigned to each loan. The model is calibrated to determine the estimated losses over a year and was developed based on previous experience.

The consumer and mortgage loan portfolio is rated through the above-described model, with grades being assigned based on the default probability for each loan. The rating scale consists of 22 levels for increased portfolio functionality by rating. The trend in the distribution of the portfolio grouped by rating grades is part of the data used for managing and following-up on the credit quality of the loan portfolio.

Methodology used to determine the allowances for loan losses

Through official document number 601-II-DGSIFIC-7651/2005, dated February 4, 2005, the Banking Commission renewed the authorization to the Bank to continue using its internal rating models for a 2-year period beginning on December 1, 2004. Loans are rated and provided for in accordance with the provisions of the Banking Commission.

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The models consider the following risk factors: country risk, financial performance, financial hedging, debtor management, overall strength (customer's relation to the environment, competitiveness, strengths and weaknesses), account management, industry conditions, and repayment history. These factors represent the valuation of the customer's credit risk profile and are derived from the Bank's experience in statistical analyses and adaptation to the Mexican market.

Credit culture

To create and foster a credit culture, the Financial Group has permanent training programs for personnel involved in the loan origination and authorization processes. Among such programs advanced training in commercial banking practices is required, which provides support tools for the analysis and evaluation of credit risk, as well as decision-making workshops.

Implementation of prudential credit criteria

In accordance with the "prudential credit provision" issued by the Banking Commission, the Financial Group has established control measures to timely identify, measure and limit the taking of risks derived from lending activity in its different phases. These measures are documented in the Credit Policies and Procedures Manual, and are reviewed and updated on a regular basis as well as submitted to the Board of Directors for approval every year.

Quantitative information

At the end of 2005, the consumer loan portfolio remains the principal borrowing segment, followed by the governmental and corporate segments.

During the last year the Bank's commercial loan portfolio increased by 7.7%. The past-due portfolio index was 2.1%.

Current and past-due consumer and mortgage portfolios are analyzed in note 9a. Past-due portfolio indexes as of December 31, 2005 are as follows: commercial loans, 3.26%; mortgage loans, 5.86% and combined 4.29%.

Operational risk

Operational risk is the risk of loss arising from frauds, unauthorized activities, errors, omissions, inefficiencies, systems failures or external events. They are all subject to the Bank's risk management. This definition excludes the strategic or reputational risks, which are part of other risk management agenda of the Financial Group.

For operational risk management, a specialized central unit has been established. Additionally, about a hundred middle-management officers have been designated, who in addition to their own business or support areas, maintain a functional relationship with the operational risk management unit and deal with the relevant risk management activities.

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During the second half of 2005, all of the operational risks throughout the Financial Group's structure were identified and re-assessed for the second time. During the year, in addition to denominating and classifying all identifiable operational risks, three parameters were evaluated for each identified risk: feasibility, impact and exposure.

Based on the values obtained from the parameters, a risk rating was determined to which one of the first four letters of the alphabet (A, B, C or D) was assigned depending on their higher or lower significance.

Furthermore, for the third year in a row, in 2005 major events were recorded and inputted into a database specifically designed for that purpose. The database will become in the future, as statistical significance is attained, the supporting tool for computing capital allowances for operational risks.

Both risks evaluated and assessed and the events that occurred in the year have been marked with the appropriate label to classify them within the various risk categories, based on the following taxonomy:

Individuals: Employee fraud/ Malice (crime), Unauthorized activities/ Employee misconduct (intentional), Labor Law, Labor interruptions and Key personnel loss or understaffing.

Processes: Procedure risk, Valuation/Pricing, Internal and external information and legal compliance, Project risk management/changes and Sales risks.

Systems: Information technology investments risk, Systems development and implementation, Systems failures, Systems security failures, Information capacity.

External: Legal/civil liability, Criminal activities, Externalization risks/Vendors, Disaster and infrastructure service failures, Regulatory risk and Political/Government risks.

The operational risk category includes additionally two specific risk classes: technological and legal risks.

Aware of the importance of exercising an appropriate control over technological risk, the Financial Group's information technology processes have been subjected to an ISO 9001 certification procedure and, therefore, a stringent methodology is in place for their operation, and plenty of relevant documentation is available. This documentation is contained in a computer information application designed for that purpose by the ISO certifier, and is available for review by the supervising authority.

Furthermore, for legal risk management actions have been taken which include: establishing policies and procedures for proper legal proceedings and execution of judicial acts; allowances for potential losses arising from adverse judicial or administrative resolutions; making employees and officers aware of the judicial and administrative provisions applicable to relevant operations; conducting statutory audits, the latest of which was made in July 2005; as well as implementing a historical database on judicial and administrative resolutions, relevant grounds and costs.