

Report Prepared On: 12/14/12

Structured Product Details

Name	Reverse Convertible Notes linked to Arch Coal, Inc.
Issue Size	\$126,000
Issue Price	\$1,000
Term	3 Months
Annualized Coupon	20.00%
Pricing Date	July 7, 2008
Issue Date	July 10, 2008
Valuation Date	October 7, 2008
Maturity Date	October 10, 2008
Issuer	HSBC
CDS Rate	224.37 bps
Swap Rate	2.77%
Reference Asset	Arch Coal, Inc.'s stock
Initial Level	\$63.30
Trigger Price	\$44.31
Conversion Price	\$24.35
Dividend Rate	0.47%
Implied Volatility	68.31%
Delta¹	0.44
Fair Price at Issue	\$932.14
Realized Return	-96.70%
CUSIP	4042K0QT5
SEC Link	www.sec.gov/Archives/edgar/data/83246/000114420408039235/v119507_424b2.htm

Related Research

Research Papers:

www.slcg.com/research.php

- "Are Structured Products Suitable for Retail Investors?" December 2006.
- "Structured Products in the Aftermath of Lehman Brothers," November 2009.
- "What TiVo and JP Morgan Teach Us about Reverse Convertibles," June 2010.

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Reverse Convertible Notes linked to Arch Coal, Inc.

Description

HSBC issued \$126,000 of Reverse Convertible Notes linked to Arch Coal, Inc. on July 10, 2008 at \$1,000 per note.

These notes are HSBC-branded reverse convertibles. Reverse convertibles pay periodic interest coupons and at maturity convert into shares of the reference security if the price of the reference stock at the notes' maturity is below its price when the notes were issued and had closed below a specified "trigger" during the term of the notes.

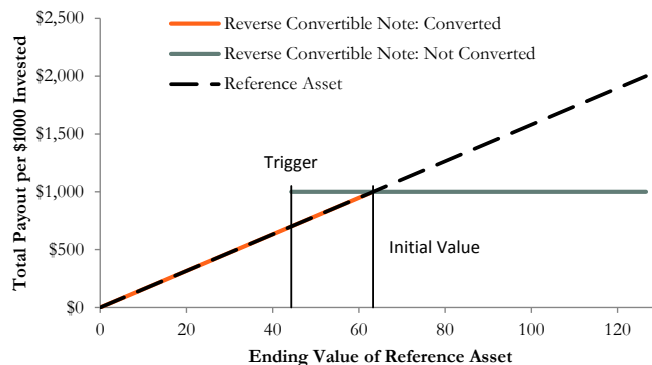
These 3-month notes pay monthly coupons at an annualized rate of 20.00%. In addition to the monthly coupons, at maturity on October 10, 2008 investors will receive the market value of 15.80 shares of Arch Coal, Inc.'s stock if on October 7, 2008 Arch Coal, Inc.'s stock price closes below \$63.30 (Arch Coal, Inc.'s stock price on July 7, 2008) and had ever closed at or below \$44.31 during the term of the notes. Otherwise, investors will receive the \$1,000 face value per note.

Valuation

This HSBC reverse convertible linked to Arch Coal, Inc.'s stock can be valued as a combination of a note from HSBC and a short down-and-in, at-the-money put option on Arch Coal, Inc.'s stock. For reasonable valuation inputs this note was worth \$932.14 per \$1,000 when it was issued on July 10, 2008 because investors were effectively being paid only \$37.14 for giving HSBC an option which was worth \$104.99.

There is no active secondary market for most structured products. Structured products, including this note, therefore are much less liquid than simple stocks, bonds, notes and mutual funds. Investors are likely to receive less than the structured product's estimated market value if they try to sell the structured product prior to maturity. Our valuations do not incorporate this relative lack of liquidity and therefore should be considered an upper bound on the value of the structured product.

Payoff Curve at Maturity

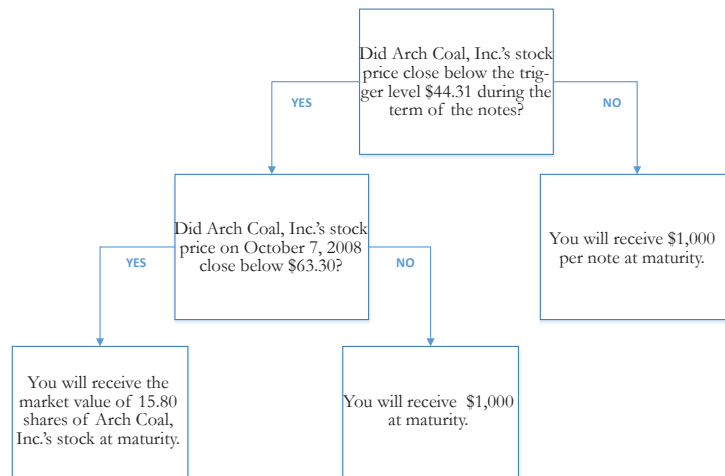


The payoff diagram shows the final payoff of this note given Arch Coal, Inc.'s stock price (horizontal axis). For comparison, the dashed line shows the payoff if you invested in Arch Coal, Inc.'s stock directly.

Principal Payback Table

Arch Coal, Inc.'s Stock	Converted Note Payoff	Non-Converted Note Payoff
\$0.00	\$0.00	
\$6.33	\$100.00	
\$12.66	\$200.00	
\$18.99	\$300.00	
\$25.32	\$400.00	
\$31.65	\$500.00	
\$37.98	\$600.00	
\$44.31	\$700.00	\$1,000.00
\$50.64	\$800.00	\$1,000.00
\$56.97	\$900.00	\$1,000.00
\$63.30	\$1,000.00	\$1,000.00
\$69.63	\$1,000.00	\$1,000.00
\$75.96	\$1,000.00	\$1,000.00
\$82.29	\$1,000.00	\$1,000.00
\$88.62	\$1,000.00	\$1,000.00
\$94.95	\$1,000.00	\$1,000.00

Maturity Payoff Diagram



The contingent payoffs of this Reverse Convertible Note.

Analysis

This reverse convertible's 20.00% coupon rate is higher than the yield HSBC paid on its straight debt but, in addition to HSBC's credit risk, investors bear the risk that they will receive shares of Arch Coal, Inc.'s stock when they are worth substantially less than the face value of the note at maturity.

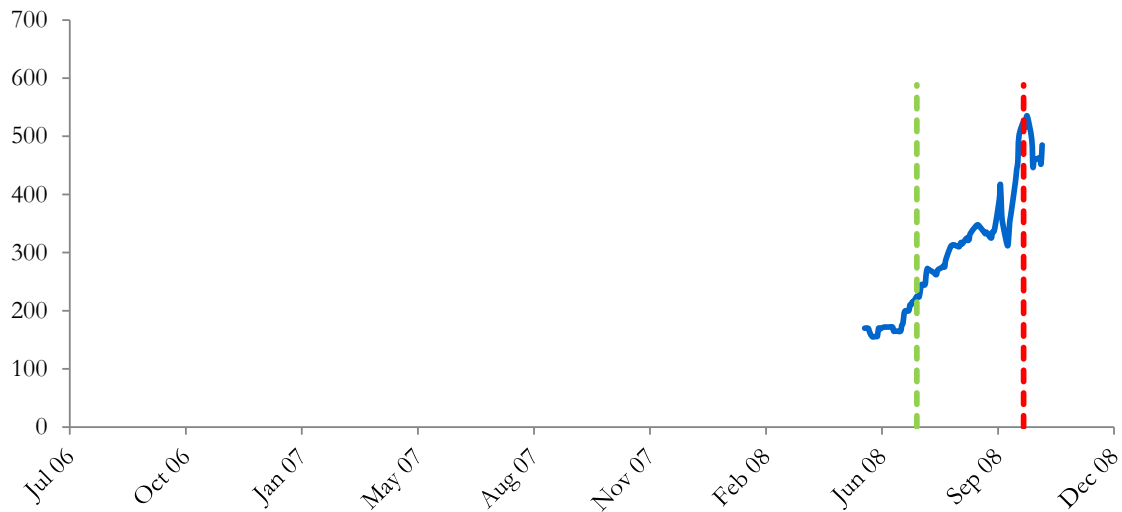
Investors purchasing reverse convertibles effectively sell put options to HSBC and post the note's issue price as collateral to secure satisfaction of the investors' obligations under the option contracts. HSBC pays investors a "coupon" that is part payment for the put options and part interest on the investors' posted collateral. This reverse convertible is fairly priced if and only if the excess of the reverse convertible's "coupon rate" above the interest HSBC pays on its straight debt equals the value of the put option investors are giving to HSBC. Whether the reverse convertible is suitable or not is equivalent to whether selling put options on the reference stock at the option premium being paid by HSBC was suitable for the investor.

HSBC's Stock Price



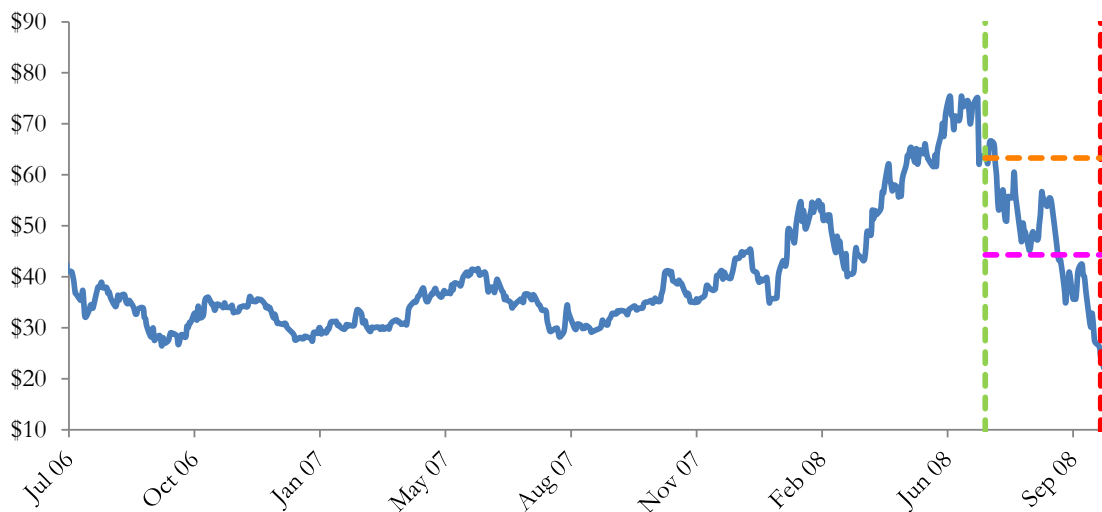
The graph above shows the adjusted closing price of the issuer HSBC for the past several years. The stock price of the issuer is an indication of the financial strength of HSBC. The adjusted price shown above incorporates any stock split, reverse stock split, etc.

HSBC's CDS Rate



Credit default swap (CDS) rates are the market price that investors require to bear credit risk of an issuer such as HSBC. CDS rates are usually given in basis points (bps). One basis point equals 0.01%. Higher CDS rates reflect higher perceived credit risk, higher required yields, and therefore lower market value of HSBC's debt, including outstanding Reverse Convertible Note. Fluctuations in HSBC's CDS rate impact the market value of the notes in the secondary market.

Arch Coal, Inc.'s Stock Price

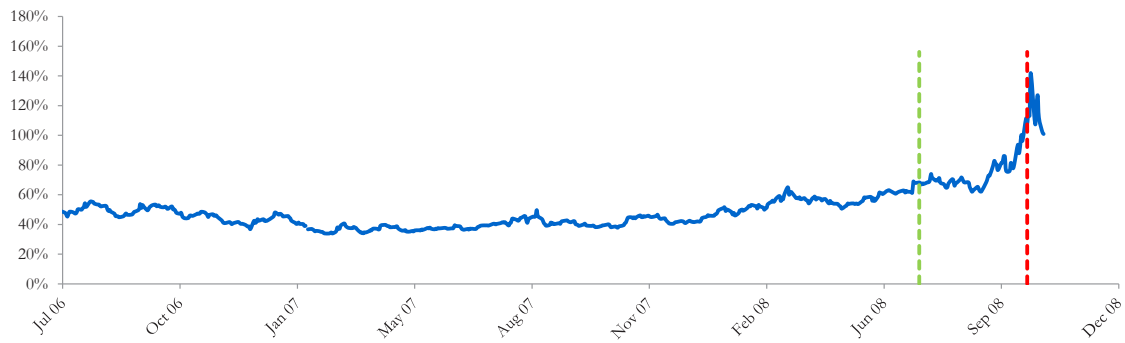


The graph above shows the historical levels of Arch Coal, Inc.'s stock for the past several years. The final payoff of this note is determined by Arch Coal, Inc.'s stock price at maturity. Higher fluctuations in Arch Coal, Inc.'s stock price correspond to a greater uncertainty in the final payout of this Reverse Convertible Note.

Realized Payoff

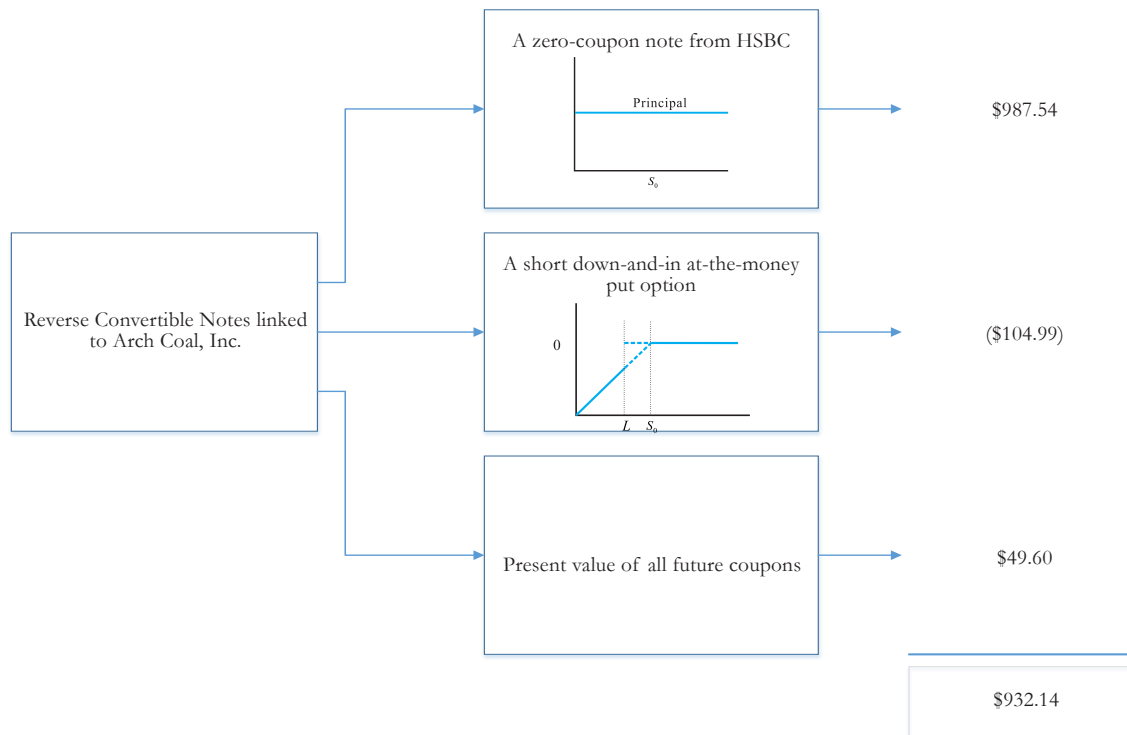
This note matured on October 10, 2008 and investors received \$384.68 per note (or equal to the value of 15.80 shares of Arch Coal, Inc. stock's closing price on October 7, 2008).

Reference Asset Arch Coal, Inc.'s Stock's Implied Volatility



The annualized implied volatility of Arch Coal, Inc.'s stock on July 7, 2008 was 68.31%, meaning that options contracts on Arch Coal, Inc.'s stock were trading at prices that reflect an expected annual volatility of 68.31%. The higher the implied volatility, the larger the expected fluctuations of Arch Coal, Inc.'s stock price and of the Note's market value during the life of the Notes.

Decomposition of this Reverse Convertible Note



This note can be decomposed into different components, and each component can be valued separately. The chart above shows the value of each component of this Reverse Convertible Note.

1. Delta measures the sensitivity of the price of the note to the Arch Coal, Inc.'s stock price on July 7, 2008.
2. CDS rates can be considered a measure of the probability that an issuer will default over a certain period of time and the likely loss given a default. The lower the CDS rate, the lower the default probability. CDS rate is given in basis points (1 basis point equals 0.01%), and is considered as a market premium, on top of the risk-free rate, that investors require to insure against a potential default.
3. Fair price evaluation is based on the Black-Scholes model of the Arch Coal, Inc.'s stock on July 7, 2008.
4. Calculated payout at maturity is only an approximation, and may differ from actual payouts at maturity.
5. Our evaluation does not include any transaction fees, broker commissions, or liquidity discounts on the notes.