



The Hongkong and Shanghai Banking
Corporation Limited

Interim Disclosure Statement
*prepared under the Banking (Disclosure) Rules
made pursuant to section 60A of the Banking Ordinance*

Supplementary Notes
for the six months ended 30 June 2011

The information contained in this document is for The Hongkong and Shanghai Banking Corporation Limited ('the Bank') and its subsidiaries (together 'the group'). It is supplementary to and should be read in conjunction with the 2011 Interim Consolidated Results Press Release issued on 1 August 2011, available at www.hsbc.com.hk. The information in the two documents, taken together, complies with the Banking (Disclosure) Rules made under section 60A of the Banking Ordinance.

1. Basis of preparation

a. The group uses the advanced internal ratings-based approach to calculate its credit risk for the majority of its non-securitisation exposures and the internal ratings-based (securitisation) approach to determine credit risk for its securitisation exposures. For market risk, the group uses an internal models approach to calculate its general market risk and market risk relating to equity options. The group uses an internal models approach to calculate its market risk in respect of specific risk for the interest rate risk category. The group uses the standardised (market risk) approach for calculating other market risk positions and the standardised (operational risk) approach to calculate its operational risk. There are no changes in the approaches used in 2011.

b. Except where indicated otherwise, the financial information contained in these supplementary notes has been prepared on a consolidated basis. The basis of consolidation for regulatory purposes is different from that for accounting purposes. Further information regarding subsidiaries that are not included in the consolidation for regulatory purposes is set out in Supplementary Note 26.

c. The accounting policies applied in preparing these supplementary notes are the same as those applied in preparing the consolidated financial statements for the year ended 31 December 2010, as set out in Note 3 on the financial statements on pages 38 to 54 of the Annual Report and Accounts.

2. Net interest income

	Half-year ended 30 June 2011 HK\$m	Half-year ended 30 June 2010 HK\$m
Net interest income includes the following:		
- interest income accrued on impaired financial assets	<u>183</u>	<u>168</u>

3. Net fee income

	Half-year ended 30 June 2011 HK\$m	Half-year ended 30 June 2010 HK\$m
Net fee income includes the following:		
Net fee income, other than amounts included in determining the effective interest rate, arising from financial assets or financial liabilities that are not held for trading or designated at fair value		
- fee income	7,468	6,393
- fee expense	<u>(664)</u>	<u>(648)</u>
	<u>6,804</u>	<u>5,745</u>
Net fee income arising from trust and other fiduciary activities where the group holds or invests assets on behalf of its customers		
- fee income	4,928	3,838
- fee expense	<u>(642)</u>	<u>(455)</u>
	<u>4,286</u>	<u>3,383</u>

4. Gains less losses on loans and receivables, held-to-maturity investments and financial liabilities measured at amortised cost

	Half-year ended 30 June 2011 HK\$m	Half-year ended 30 June 2010 HK\$m
Loans and receivables	<u>373</u>	<u>583</u>

There are no gains or losses on held-to-maturity investments or financial liabilities measured at amortised cost for the half-year ended 30 June 2011 and 30 June 2010.

5. Dividend income

	Half-year ended 30 June 2011 HK\$m	Half-year ended 30 June 2010 HK\$m
Listed investments	313	283
Unlisted investments	<u>232</u>	<u>45</u>
	<u>545</u>	<u>328</u>

6. Cash and short-term funds

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Cash in hand	13,112	13,001
Sight balances with central banks	100,085	68,380
Placing with banks with remaining maturity of one month or less	532,588	447,524
Treasury bills and other eligible bills	306,826	279,080
	<u>952,611</u>	<u>807,985</u>

As at 30 June 2011, included within notes 6 and 7, the total amount placed with central banks, including sight balances, amounted to HK\$409,288m (31 December 2010: HK\$232,779m).

7. Placings with banks maturing after one month

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Gross placings with banks maturing after one month but not more than one year	142,097	142,313
Gross placings with banks maturing after one year	21,376	7,244
Total placings with banks maturing after one month	<u>163,473</u>	<u>149,557</u>

There are no significant overdue, impaired or rescheduled placings with banks as at 30 June 2011 and 31 December 2010.

8. Certificates of deposit

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Held-to-maturity	8,204	6,290
Available-for-sale	78,433	66,957
	<u>86,637</u>	<u>73,247</u>

9. Advances to customers**a. Analysis of advances to customers by industry sector based on categories and definitions used by the Hong Kong Monetary Authority ('HKMA')**

The following analysis of the group's advances to customers is based on the categories contained in the 'Quarterly Analysis of Loans and Advances and Provisions' return required to be submitted to the HKMA by branches of the Bank and by banking subsidiary companies in Hong Kong.

	Gross Advances		Collateral and other security	
	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m (restated¹)	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m (restated¹)
<i>Industrial, commercial and financial</i>				
Property development	76,073	74,177	21,893	21,227
Property investment	205,236	187,120	151,162	142,417
Financial concerns	13,315	12,206	2,459	2,362
Stockbrokers	2,243	1,993	136	178
Wholesale and retail trade	85,552	68,303	21,727	17,902
Manufacturing	39,302	34,924	7,795	7,352
Transport and transport equipment	27,213	24,372	19,111	17,637
Recreational activities	860	945	785	532
Information technology	6,539	5,844	22	13
Others	75,619	73,039	23,802	20,375
	531,952	482,923	248,892	229,995
<i>Individuals</i>				
Advances for the purchase of flats under the Hong Kong Government's Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme	26,417	27,496	26,382	27,458
Advances for the purchase of other residential properties	288,589	267,133	288,567	267,089
Credit card advances	35,725	37,351	–	–
Others	39,922	36,634	12,633	11,757
	390,653	368,614	327,582	306,304
Gross advances to customers for use in Hong Kong	922,605	851,537	576,474	536,299
Trade finance	180,240	135,650	33,261	27,332
Gross advances to customers for use outside Hong Kong made by branches of the Bank and subsidiaries in Hong Kong	95,468	74,201	3,519	1,720
Gross advances to customers made by branches of the Bank and subsidiaries in Hong Kong	1,198,313	1,061,388	613,254	565,351
Gross advances to customers made by branches of the Bank and subsidiaries outside Hong Kong	937,452	842,666	385,893	353,358
Gross advances to customers	2,135,765	1,904,054	999,147	918,709

1 Certain comparatives have been restated to reflect changes in classification in the current period disclosure

9. Advances to customers (continued)**a. Analysis of advances to customers by industry sector based on categories and definitions used by the Hong Kong Monetary Authority ('HKMA') (continued)**

The most common method of mitigating credit risk is to take collateral. Collateral includes any tangible security that has a determinable fair market value and is readily marketable. This includes (but is not limited to) cash and deposits, stocks and bonds, mortgages over properties and charges over other fixed assets such as plant and equipment. Where collateral values are greater than gross advances, only the amount of collateral up to the gross advance is included.

b. Individually assessed impaired advances to customers

The geographical information shown below has been classified by the location of the principal operations of the subsidiary company or, in the case of the Bank, by the location of the branch responsible for advancing the funds.

	Hong Kong HK\$m	Rest of Asia-Pacific HK\$m	Total HK\$m
At 30 June 2011			
Gross individually assessed impaired advances	3,656	9,451	13,107
Individually assessed impairment allowances	<u>(2,238)</u>	<u>(4,825)</u>	<u>(7,063)</u>
	<u>1,418</u>	<u>4,626</u>	<u>6,044</u>
Gross individually assessed impaired advances as a percentage of gross advances to customers	0.3%	1.0%	0.6%
Fair value of collateral which has been taken into account in respect of individually assessed impaired advances to customers	1,194	2,944	4,138
At 31 December 2010			
Gross individually assessed impaired advances	4,804	10,210	15,014
Individually assessed impairment allowances	<u>(2,615)</u>	<u>(5,644)</u>	<u>(8,259)</u>
	<u>2,189</u>	<u>4,566</u>	<u>6,755</u>
Gross individually assessed impaired advances as a percentage of gross advances to customers	0.5%	1.2%	0.8%
Fair value of collateral which has been taken into account in respect of individually assessed impaired advances to customers	1,463	2,887	4,350

The most common method of mitigating credit risk is to take collateral. Collateral includes any tangible security that has a determinable fair market value and is readily marketable. This includes (but is not limited to) cash and deposits, stocks and bonds, mortgages over properties and charges over other fixed assets such as plant and equipment. Where collateral values are greater than gross advances, only the amount of collateral up to the gross advance is included.

9. Advances to customers *(continued)***b. Individually assessed impaired advances to customers** *(continued)*

For individually assessed customer advances where the industry sectors comprise not less than 10% of the total gross advances to customers, the analysis of gross impaired advances and allowances by major industry sectors based on categories and definitions used by the HSBC Group is as follows:

	Total gross advances HK\$m	Gross impaired advances HK\$m	Individually assessed allowances HK\$m	Collectively assessed allowances HK\$m
At 30 June 2011				
Residential mortgages	573,080	2,353	(411)	(193)
Commercial, industrial and international trade	694,830	7,408	(5,149)	(1,938)
Commercial real estate	230,905	771	(256)	(66)
At 31 December 2010				
Residential mortgages	520,829	2,274	(375)	(216)
Commercial, industrial and international trade	585,273	8,445	(5,989)	(1,898)
Commercial real estate	217,946	893	(254)	(54)

Collectively assessed allowances refer to impairment allowances which are assessed on a collective basis for those individually assessed advances where an individual impairment has not yet been identified.

9. Advances to customers (continued)**c. Overdue advances to customers**

The geographical information shown below and in note 9d has been classified by the location of the principal operations of the subsidiary or, in the case of the Bank, by the location of the branch responsible for advancing the funds.

	Hong Kong		Rest of Asia-Pacific		Total	
	HK\$m	%	HK\$m	%	HK\$m	%
At 30 June 2011						
Gross advances to customers which have been overdue with respect to either principal or interest for periods of						
– more than three months but not more than six months	290	0.0	1,954	0.2	2,244	0.1
– more than six months but not more than one year	238	0.0	799	0.1	1,037	0.1
– more than one year	1,849	0.2	3,451	0.4	5,300	0.2
	2,377	0.2	6,204	0.7	8,581	0.4
Individually assessed impairment allowances made in respect of such overdue advances	(1,543)		(3,170)		(4,713)	
Fair value of collateral held in respect of overdue advances	603		1,962		2,565	
At 31 December 2010						
Gross advances to customers which have been overdue with respect to either principal or interest for periods of						
– more than three months but not more than six months	341	0.0	1,906	0.2	2,247	0.1
– more than six months but not more than one year	974	0.1	825	0.1	1,799	0.1
– more than one year	2,234	0.2	4,345	0.5	6,579	0.4
	3,549	0.3	7,076	0.8	10,625	0.6
Individually assessed impairment allowances made in respect of such overdue advances	(1,923)		(3,824)		(5,747)	
Fair value of collateral held in respect of overdue advances	823		2,044		2,867	

The most common method of mitigating credit risk is to take collateral. Collateral includes any tangible security that has a determinable fair market value and is readily marketable. This includes (but is not limited to) cash and deposits, stocks and bonds, mortgages over properties and charges over other fixed assets such as plant and equipment. Where collateral values are greater than gross advances, only the amount of collateral up to the gross advance is included.

9. Advances to customers *(continued)***d. Rescheduled advances to customers**

	Hong Kong		Rest of Asia-Pacific		Total	
	HK\$m	%	HK\$m	%	HK\$m	%
At 30 June 2011	1,409	0.1	2,217	0.2	3,626	0.2
At 31 December 2010	891	0.1	2,793	0.3	3,684	0.2

Rescheduled advances to customers are those advances which have been restructured or renegotiated because of a deterioration in the financial position of the borrower, or because of the inability of the borrower to meet the original repayment schedule.

Rescheduled advances to customers are stated net of any advances which have subsequently become overdue for more than three months and which are included in 'Overdue advances to customers' (note 9c).

e. Analysis of advances to customers by geographical areas according to the location of counterparties, after recognised risk transfer

	Hong Kong HK\$m	Rest of Asia-Pacific HK\$m	Total HK\$m
At 30 June 2011			
Gross advances to customers	<u>982,544</u>	<u>1,153,221</u>	<u>2,135,765</u>
At 31 December 2010			
Gross advances to customers	<u>889,862</u>	<u>1,014,192</u>	<u>1,904,054</u>

10. Non-bank Mainland exposures

The analysis of non-bank mainland exposures is based on the categories of non-bank counterparties and the type of direct exposures defined by the HKMA under the Banking (Disclosure) Rules with reference to the HKMA return for non-bank mainland exposures, which includes the mainland exposures extended by the Bank and its wholly owned banking subsidiaries in mainland China.

	On-balance sheet exposure HK\$m	Off-balance sheet exposure HK\$m	Total exposures HK\$m	Specific provisions HK\$m
At 30 June 2011				
Mainland entities	59,656	19,673	79,329	–
Companies and individuals outside the mainland where the credit is granted for use in the mainland	50,082	29,673	79,755	43
Other counterparties the exposures to whom are considered by the Bank to be non-bank mainland exposures	7,320	2,376	9,696	–
	<u>117,058</u>	<u>51,722</u>	<u>168,780</u>	<u>43</u>
Mainland exposures of wholly owned mainland subsidiaries:				
Loans and advances	118,897	4,183	123,080	34
Debt securities and other	72,846	11,700	84,546	–
	<u>191,743</u>	<u>15,883</u>	<u>207,626</u>	<u>34</u>
	<u>308,801</u>	<u>67,605</u>	<u>376,406</u>	<u>77</u>
At 31 December 2010				
Mainland entities	28,577	13,533	42,110	1
Companies and individuals outside the mainland where the credit is granted for use in the mainland	48,674	40,994	89,668	641
Other counterparties the exposures to whom are considered by the Bank to be non-bank mainland exposures	4,264	2,725	6,989	–
	<u>81,515</u>	<u>57,252</u>	<u>138,767</u>	<u>642</u>
Mainland exposures of wholly owned mainland subsidiaries:				
Loans and advances	111,146	2,995	114,141	36
Debt securities and other	54,473	9,940	64,413	–
	<u>165,619</u>	<u>12,935</u>	<u>178,554</u>	<u>36</u>
	<u>247,134</u>	<u>70,187</u>	<u>317,321</u>	<u>678</u>

11. Cross-border exposures

The group's country risk exposures in the table below are prepared in accordance with the HKMA return of External Positions Part II: Cross-Border Claims (MA(BS)9B) guidelines.

Cross-border claims are on-balance sheet exposures to counterparties based on the location of the counterparties after taking into account the transfer of risk.

The table shows claims on individual countries and territories or areas, after recognised risk transfer, amounting to not less than 10% of the aggregate cross-border claims.

Cross-border risk is controlled centrally through a well-developed system of country limits and is frequently reviewed to avoid concentration of transfer, economic or political risk.

	Banks and other financial institutions HK\$m	Public sector entities HK\$m	Others HK\$m	Total HK\$m
As at 30 June 2011				
Asia-Pacific excluding Hong Kong				
China	268,228	31,114	80,184	379,526
Others	125,421	125,617	243,336	494,374
	<u>393,649</u>	<u>156,731</u>	<u>323,520</u>	<u>873,900</u>
Europe				
United Kingdom	149,361	3,643	16,178	169,182
Others	130,127	59,951	47,172	237,250
	<u>279,488</u>	<u>63,594</u>	<u>63,350</u>	<u>406,432</u>
Americas				
United States	58,558	105,037	50,730	214,325
Others	20,707	24,431	80,380	125,518
	<u>79,265</u>	<u>129,468</u>	<u>131,110</u>	<u>339,843</u>
As at 31 December 2010 (restated¹)				
Asia-Pacific excluding Hong Kong				
China	159,097	9,839	64,976	233,912
Others	104,955	134,469	218,612	458,036
	<u>264,052</u>	<u>144,308</u>	<u>283,588</u>	<u>691,948</u>
Europe				
United Kingdom	157,840	1,364	13,914	173,118
Others	148,184	63,717	34,529	246,430
	<u>306,024</u>	<u>65,081</u>	<u>48,443</u>	<u>419,548</u>
Americas				
United States	107,736	94,888	57,250	259,874
Others	22,435	16,719	68,685	107,839
	<u>130,171</u>	<u>111,607</u>	<u>125,935</u>	<u>367,713</u>

¹ Comparatives have been restated to reflect the accounting consolidation followed in the current period disclosure

12. Financial investments

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Debt securities		
– held-to-maturity	124,696	121,743
– available-for-sale	592,942	632,084
Equity shares		
– available-for-sale	<u>66,080</u>	<u>72,835</u>
	<u>783,718</u>	<u>826,662</u>

Included in the above are debt securities of HK\$29m overdue for more than one year (31 December 2010: HK\$26m overdue for between 6 months and 1 year).

13. Interests in associates

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Interests in associates	<u>81,134</u>	<u>74,099</u>

14. Property, plant and equipment

	Land and buildings HK\$m	Investment properties HK\$m	Equipment HK\$m	Total HK\$m
Cost or valuation at 1 January 2011	63,148	3,503	20,530	87,181
Exchange and other adjustments	212	–	182	394
Additions	169	–	792	961
Disposals	(4)	–	(272)	(276)
Elimination of accumulated depreciation on revalued land and buildings	(729)	–	–	(729)
Surplus on revaluation	6,418	427	–	6,845
At 30 June 2011	<u>69,214</u>	<u>3,930</u>	<u>21,232</u>	<u>94,376</u>
Accumulated depreciation at 1 January 2011	2	–	14,832	14,834
Exchange and other adjustments	1	–	136	137
Charge for the period	780	–	1,104	1,884
Disposals	–	–	(232)	(232)
Elimination of accumulated depreciation on revalued land and buildings	(729)	–	–	(729)
At 30 June 2011	<u>54</u>	<u>–</u>	<u>15,840</u>	<u>15,894</u>
Net book value at 30 June 2011	<u>69,160</u>	<u>3,930</u>	<u>5,392</u>	<u>78,482</u>
Net book value at 31 December 2010	<u>63,146</u>	<u>3,503</u>	<u>5,698</u>	<u>72,347</u>

15. Other assets

Included in the balance sheet within ‘Other assets’ are, *inter alia*, repossessed assets which are non-financial assets acquired in exchange for loans in order to achieve an orderly realisation, and are reported at the lower of fair value (less costs to sell) and the carrying amount of the loan (net of any impairment allowance).

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Repossessed assets	<u>85</u>	<u>51</u>

There are no significant overdue other assets as at 30 June 2011 and 31 December 2010.

16. Trading liabilities

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Certificates of deposit in issue	3,131	2,694
Other debt securities in issue	24,481	17,919
Short positions in securities	60,398	51,089
Deposits by banks	12,008	11,103
Customer accounts	112,538	68,729
	<u>212,556</u>	<u>151,534</u>

17. Financial liabilities designated at fair value

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Deposits by banks	291	288
Customer accounts	1,695	1,688
Debt securities in issue	4,139	4,605
Liabilities to customers under investment contracts	34,176	33,746
	<u>40,301</u>	<u>40,327</u>

18. Debt securities in issue

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Certificates of deposit	27,519	36,222
Other debt securities	47,880	23,061
	<u>75,399</u>	<u>59,283</u>

19. Other liabilities and provisions

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Accruals and deferred income	19,807	22,502
Provisions for liabilities and charges	1,372	1,359
Acceptances and endorsements	29,821	25,950
Share based payment liability to HSBC Holdings plc	2,346	1,812
Other liabilities	22,025	19,323
	<u>75,371</u>	<u>70,946</u>

20. Subordinated liabilities

Subordinated liabilities consist of undated primary capital notes and other loan capital having an original term to maturity of five years or more, raised by the group for the development and expansion of its business.

		At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
<i>Bank</i>			
US\$1,200m	Undated floating rate primary capital notes	9,409	9,404
<i>Group</i>			
A\$200m	Floating rate subordinated notes due 2016, callable from 2011 ¹	–	1,583
A\$42m	Floating rate subordinated notes due 2018, callable from 2013 ²	351	332
A\$200m	Floating rate subordinated notes due 2020, callable from 2015	1,671	1,583
US\$450m	Floating rate subordinated notes due 2016, callable from 2011 ³	3,501	3,495
US\$300m	Floating rate subordinated notes due 2017, callable from 2012 ⁴	2,332	2,328
RM500m	Fixed rate (4.35%) subordinated bonds due 2022, callable from 2017 ⁵	1,290	1,263
RM500m	Fixed rate (5.05%) subordinated bonds due 2027, callable from 2022 ⁶	1,299	1,266
		<u>19,853</u>	<u>21,254</u>

1 The A\$200m callable subordinated floating rate notes 2016 were redeemed in May 2011.

2 The interest rate on the A\$42m callable subordinated floating rate notes 2018 will increase by 0.5% from March 2013.

3 The US\$450m callable subordinated floating rate notes 2016 were redeemed in July 2011.

4 The interest rate on the US\$300m callable subordinated floating rate notes 2017 will increase by 0.5% from July 2012.

5 The interest rate on the RM500m 4.35% callable subordinated bonds 2022 will increase by 1% from June 2017.

6 The interest rate on the RM500m 5.05% callable subordinated bonds 2027 will increase by 1% from November 2022.

21. Off-balance sheet exposures other than derivative transactions

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Contingent liabilities and commitments		
Direct credit substitutes	56,275	50,451
Transaction-related contingencies	103,545	85,599
Trade-related contingencies	108,064	99,711
Forward asset purchases	3,099	3,194
Forward deposits placed	–	259
Commitments that are unconditionally cancellable without prior notice	1,158,543	1,059,747
Commitments which have an original maturity of not more than one year	111,816	104,720
Commitments which have an original maturity of more than one year	137,769	132,343
	<u>1,679,111</u>	<u>1,536,024</u>
Risk-weighted amounts	<u>202,322</u>	<u>217,098</u>

The table above gives the nominal contract amounts and risk-weighted amounts of contingent liabilities and commitments. The information is consistent with that in the ‘Capital Adequacy Ratio’ return submitted to the HKMA. The return is prepared on a consolidated basis as specified by the HKMA under the requirement of section 98(2) of the Banking Ordinance.

For accounting purposes, acceptances and endorsements are recognised on the balance sheet in ‘Other assets’ in accordance with Hong Kong Accounting Standard 39 ‘Financial Instruments: Recognition and Measurement’. For the purposes of the Banking (Capital) Rules, acceptances and endorsements are included in the capital adequacy calculation as if they were contingencies.

Contingent liabilities and commitments are credit-related instruments. The contract amounts represent the amounts at risk should the contracts be fully drawn upon and the customers default. Since a significant portion of guarantees and commitments are expected to expire without being drawn upon, the total of the contract amounts is not representative of expected future cash flows.

22. Derivative transactions**a. Contract amounts of derivative transactions**

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Exchange rate	10,588,842	8,834,664
Interest rate	19,266,274	15,938,211
Credit derivative	506,132	531,899
Equities, commodity and other	819,833	494,869
	<u>31,181,081</u>	<u>25,799,643</u>

Derivatives arise from futures, forward, swap and option transactions undertaken by the group in the foreign exchange, interest rate, equity, credit and commodity markets. The contract amounts of these instruments included in the table above indicate the volume of transactions outstanding at the balance sheet date. They do not represent amounts at risk.

b. Risk exposures to derivative transactions

	Contract amount HK\$m	Risk- weighted amount HK\$m	Fair value ¹ HK\$m
At 30 June 2011			
Exchange rate	9,461,444	41,179	46,970
Interest rate	16,855,722	19,241	25,557
Credit derivative	515,865	1,543	1,468
Equities, commodity and other	331,851	2,283	6,800
	<u>27,164,882</u>	<u>64,246</u>	<u>80,795</u>
At 31 December 2010			
Exchange rate	7,934,322	35,903	44,359
Interest rate	14,446,708	17,372	21,459
Credit derivative	536,396	1,284	743
Equities, commodity and other	208,054	1,260	4,236
	<u>23,125,480</u>	<u>55,819</u>	<u>70,797</u>

¹ Fair value is calculated after taking into account the effect of valid bilateral netting agreements amounting to HK\$234,252m at 30 June 2011 (31 December 2010: HK\$225,484m).

22. Derivative transactions *(continued)*

The table above gives the contract amounts, the risk-weighted amounts and the fair value of derivative exposures. The information is consistent with that in the 'Capital Adequacy Ratio' return submitted to the HKMA. The return is prepared on a consolidated basis as specified by the HKMA under the requirement of section 98(2) of the Banking Ordinance.

Fair value is a close approximation of the credit risk for these contracts at the balance sheet date. The actual credit risk is measured internally as the sum of positive fair values and an estimate for the future fluctuation risk, using a future risk factor.

The netting benefits represent amounts where the group has in place legally enforceable rights of offset with individual counterparties to offset the gross amount of positive mark-to-market assets with any negative mark-to-market liabilities with the same customer. These offsets are recognised by the HKMA in the calculation of risk-weighted amounts for the capital adequacy ratio.

23. Foreign exchange exposure

Foreign exchange exposures may be divided broadly into two categories: structural and non-structural. Structural exposures are normally long-term in nature and include those arising from investments in overseas subsidiaries, branches, associates and strategic investments as well as capital instruments denominated in currencies other than Hong Kong dollars. Non-structural exposures arise primarily from trading positions and balance sheet management activities. Non-structural exposures can arise and change rapidly. Foreign currency exposures are managed in accordance with the group's risk management policies and procedures.

The group had the following net structural foreign currency exposures that were not less than 10% of the total net structural positions in all foreign currencies:

	Net structural position	
	LCYm	HK\$m
At 30 June 2011		
Chinese renminbi	122,999	148,089
Indian rupees	177,905	30,970
At 31 December 2010		
Chinese renminbi	122,017	143,909
Indian rupees	179,314	31,178

23. Foreign exchange exposure *(continued)*

The group had the following non-structural foreign currency positions at 30 June 2011. The USD, SGD and BRD positions were not less than 10% of the group's net non-structural positions in all foreign currencies at 30 June 2011:

	United States dollars HK\$m	Singapore dollars HK\$m	Brunei dollars HK\$m	Chinese renminbi HK\$m
At 30 June 2011				
Spot assets	1,526,653	227,525	83,594	467,344
Spot liabilities	(1,529,711)	(317,848)	(164)	(450,888)
Forward purchases	5,552,811	411,388	245	834,560
Forward sales	(5,574,469)	(310,300)	(95,178)	(852,211)
Net options positions	<u>10,395</u>	<u>(176)</u>	<u>–</u>	<u>(27)</u>
	<u>(14,321)</u>	<u>10,589</u>	<u>(11,503)</u>	<u>(1,222)</u>
At 31 December 2010 (restated¹)				
Spot assets	1,458,457	179,021	74,242	346,735
Spot liabilities	(1,384,662)	(259,611)	(157)	(326,110)
Forward purchases	4,681,128	262,154	150	649,086
Forward sales	(4,782,471)	(170,847)	(84,574)	(671,050)
Net options positions	<u>13,842</u>	<u>(127)</u>	<u>–</u>	<u>(100)</u>
	<u>(13,706)</u>	<u>10,590</u>	<u>(10,339)</u>	<u>(1,439)</u>

The net options positions reported above are calculated using the delta-weighted position of the options contracts.

¹ Comparatives have been restated to exclude internally generated back to back positions.

24. Liquidity ratio

The Banking Ordinance requires banks operating in Hong Kong to maintain a minimum liquidity ratio of 25%, calculated in accordance with the provisions of the Fourth Schedule of the Banking Ordinance. This requirement applies separately to the Hong Kong branches of the Bank and to those subsidiary companies which are authorised institutions under the Banking Ordinance.

The average liquidity ratios for the period are as follows:

	Half-year ended 30 June 2011 %	Half-year ended 30 June 2010 %
Hong Kong branches of the Bank	<u>33.3</u>	<u>42.6</u>

25. Capital adequacy

The capital ratios and risk weighted assets on a consolidated basis, calculated in accordance with the Banking (Capital) Rules, are as follows:

Capital Ratios

	At 30 June 2011 %	At 31 December 2010 %
Capital adequacy ratio	14.5	14.7
Core capital ratio	11.7	11.7

Risk weighted assets

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Credit risk	1,377,184	1,303,535
Counterparty risk	65,095	56,451
Market risk	52,865	35,251
Operational risk	218,897	216,866
Total	<u>1,714,041</u>	<u>1,612,103</u>

Deductible items

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Total of items deductible 50% from core capital and 50% from supplementary capital	<u>99,250</u>	<u>90,276</u>

The Bank and its banking subsidiaries maintain a regulatory reserve to satisfy the provisions of the Banking Ordinance and local regulatory requirements for prudential supervision purposes. The effect of this requirement is to restrict the amount of reserves which can be distributed to shareholders.

In accordance with updated guidance from the HKMA, the regulatory reserve has been increased to HK\$12,774m (31 December 2010: HK\$7,702m).

There are no relevant capital shortfalls in any of the group's subsidiaries as at 30 June 2011 which are not included in its consolidation group for regulatory purposes.

The following table shows the components of the capital base contained in the 'Capital Adequacy Ratio' return required to be submitted to the HKMA by The Hongkong and Shanghai Banking Corporation Limited on a consolidated basis that is specified by the HKMA under the requirements of section 98(2) of the Banking Ordinance.

25. Capital adequacy (continued)

	At 30 June 2011 HK\$m	At 31 December 2010 HK\$m
Core capital:		
Share capital per balance sheet	22,494	22,494
Revaluation reserve capitalisation issue	(1,454)	(1,454)
Paid-up ordinary share capital	<u>21,040</u>	<u>21,040</u>
Paid-up irredeemable non-cumulative preference shares	51,776	51,714
Reserves per balance sheet	315,466	297,636
Proposed dividend	(7,000)	(12,000)
Unconsolidated subsidiaries	(30,149)	(26,320)
Cash flow hedging reserve	(164)	(106)
Regulatory reserve	(12,774)	(7,702)
Reserves arising from revaluation of property and unrealised gains on available-for-sale equities and debt securities	(90,729)	(92,065)
Unrealised gains on equities and debt securities designated at fair value	(148)	(191)
Own credit spread	<u>(215)</u>	<u>(231)</u>
Total reserves included in core capital	<u>174,287</u>	<u>159,021</u>
Non-controlling interests per balance sheet	28,674	27,305
Non-controlling interests in unconsolidated subsidiaries	(2,782)	(2,574)
Regulatory adjustments to non-controlling interests	<u>(1,891)</u>	<u>(2,002)</u>
Non-controlling interests	<u>24,001</u>	<u>22,729</u>
Goodwill and intangible assets	(20,115)	(19,977)
50% of unconsolidated investments	(49,356)	(44,946)
50% of securitisation positions and other deductions	<u>(269)</u>	<u>(192)</u>
Deductions	<u>(69,740)</u>	<u>(65,115)</u>
Total core capital	<u>201,364</u>	<u>189,389</u>
Supplementary capital:		
Paid-up irredeemable cumulative preference shares	16,576	16,557
Perpetual subordinated debt	9,409	9,404
Paid-up term preference shares	33,075	33,035
Term subordinated debt	16,560	17,957
Property revaluation reserves ¹	7,977	7,977
Unrealised gains on available-for-sale equities and debt securities ²	2,423	3,194
Unrealised gains on equities and debt securities designated at fair value	66	86
Regulatory reserve ³	1,724	1,100
Collective impairment allowances ³	561	625
Excess impairment allowances over expected losses ⁴	<u>7,587</u>	<u>2,534</u>
Supplementary capital before deductions	<u>95,958</u>	<u>92,469</u>
50% of unconsolidated investments	(49,356)	(44,946)
50% of securitisation positions and other deductions	<u>(269)</u>	<u>(192)</u>
Deductions	<u>(49,625)</u>	<u>(45,138)</u>
Total supplementary capital	<u>46,333</u>	<u>47,331</u>
Capital base	<u>247,697</u>	<u>236,720</u>

25. Capital adequacy (continued)

- 1 Includes the revaluation surplus on investment properties which is reported as part of retained profits and adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.
 - 2 Includes adjustments made in accordance with the Banking (Capital) Rules issued by the HKMA.
 - 3 Total regulatory reserve and collective impairment allowances are apportioned between the standardised approach and internal ratings-based approach in accordance with the Banking (Capital) Rules issued by the HKMA. Those apportioned to the standardised approach are included in supplementary capital. Those apportioned to the internal ratings-based approach are excluded from supplementary capital.
 - 4 Excess impairment allowances over expected losses are applicable to non-securitisation exposures calculated by using the internal ratings-based approach.
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26. Principal subsidiaries and basis of consolidation

The basis of consolidation for accounting purposes is in accordance with Hong Kong Financial Reporting Standards ('HKFRS'). HKFRS is a collective term which includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants.

The major subsidiaries of the Bank for accounting purposes are:

Hang Seng Bank Limited
HSBC Bank (China) Company Limited
HSBC Bank Malaysia Berhad
HSBC Bank Australia Limited¹
HSBC Bank (Taiwan) Limited¹
HSBC Insurance (Asia) Limited¹
HSBC Life (International) Limited¹

¹ Held indirectly

The basis of consolidation for regulatory purposes is different from the basis of consolidation for accounting purposes. Subsidiaries included in the consolidation for regulatory purposes are specified in a notice from the HKMA in accordance with section 98(2) of the Banking Ordinance. Subsidiaries not included in consolidation for regulatory purposes are securities and insurance companies that are authorised and supervised by a regulator and are subject to supervisory arrangements regarding the maintenance of adequate capital to support business activities comparable to those prescribed for authorised institutions under the Banking (Capital) Rules and the Banking Ordinance. The Bank's shareholdings in these subsidiaries are deducted from its core capital and supplementary capital as determined in accordance with Part 3 of the Banking (Capital) Rules.

26. Principal subsidiaries and basis of consolidation *(continued)*

With respect to notes 21, 22b and 25, the principal subsidiaries that are not included in the consolidation for regulatory purpose are:

Hang Seng Insurance Company Limited
HSBC Insurance (Asia Pacific) Holdings Limited and subsidiaries
HSBC Futures (Singapore) Pte Ltd
HSBC Securities Japan Limited
Hang Seng General Insurance (Hong Kong) Company Limited
HSBC Securities Brokers (Asia) Limited

The group operates subsidiaries in a number of countries and territories where capital is governed by local rules and there may be restrictions on the transfer of regulatory capital and funds between members of the banking group.

27. Statutory accounts

The information in this document is not audited and does not constitute statutory accounts.

Certain financial information in this document is extracted from the statutory accounts for the year ended 31 December 2010 which have been delivered to the Registrar of Companies and the HKMA. The Auditors expressed an unqualified opinion on those statutory accounts in their report dated 28 February 2011. The Annual Report and Accounts for The Hongkong and Shanghai Banking Corporation Limited for the year ended 31 December 2010, which include the statutory accounts, can be obtained on request from Group Communications (Asia), The Hongkong and Shanghai Banking Corporation Limited, 1 Queen's Road Central, Hong Kong, and may be viewed on our website: www.hsbc.com.hk.